92d Congress } COMMITTEE PRINT
2d Session }

THE PENN CENTRAL AND OTHER RAILROADS

A REPORT TO THE SENATE COMMITTEE ON COMMERCE

PREPARED AT THE DIRECTION OF

Honorable WARREN G. MAGNUSON, Chairman

FOR THE USE OF

COMMITTEE ON COMMERCE
UNITED STATES SENATE

DECEMBER 1972

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PREFACE

DECEMBER 28, 1972.

The Senate Committee on Commerce in 1971 directed that a special staff under direction of the Committee's Transportation Counsel be formed to review the Penn Central Transportation Company. The study was to determine the reasons for the Penn Central's collapse into bankruptcy in June 1970. Further it was to explore the extent to which the malady which affected the Penn Central exists in the remainder of the rail industry.

Pursuant to the Committee's direction a special staff was assembled after the special authorizing legislation, S. Res. 81, passed the Senate on May 3, 1971. The attached report, the result of the efforts by the staff, should provide the Committee with some useful information which can be applied in future Committee deliberations on related matters.

I wish to emphasize that the conclusions and recommendations incorporated into this staff report, and which may prove to be controversial, represent the views of the members of the special staff and have neither been approved, disapproved, nor considered by the Senate Committee on Commerce.

WARREN G. MAGNUSON,
Chairman,
Committee on Commerce.

LETTER OF TRANSMITTAL

December 27, 1972.

Dear Mr. Chairman: Transmitted herewith is the Senate Commerce Committee Special Staff report analyzing the financial collapse of the Penn Central Transportation Company, pursuant to Senate Resolution 81, which was adopted by the Senate on May 3, 1971. While the principal objective of the Committee in approving this study was to determine the causes of the Penn Central collapse, it was clear from the beginning of the inquiry that the Penn Central could not be viewed in isolation. Rather, the most accurate picture of the Penn Central would of necessity include a look at the railroad industry generally to set the stage for a more balanced view of the Penn Central.

The collapse of the Penn Central focused intense public attention on the railroad and its officers. Investigations of various aspects of this most complex Corporation were undertaken by the Securities and Exchange Commission, the Interstate Commerce Commission, the House Banking and Currency Committee, the House Comittee on Interstate and Foreign Comerce, and this Committee. Early hearings conducted by the Senate Subcommittee on Surface Transportation and the Senate Commerce Committee provided the opening round in public scrutiny of certain activities by officers of the railroad.

The personal activities of the company's officers, the possibility of insider dealings with corporate stock, the jurisdiction of the Securities and Exchange Commission versus the role of the ICC and the involvement of the financial community were aspects of the Penn Central affair which were under very intensive examination by the other Federal bodies indicated above.

The principal concern of the Senate Commerce Committee is in the development of better transportation. While the Committee could have examined other facets of the Penn Central, it seemed that in view of other actions by the Federal Government, and in view of the principal concern of this Committee, it would be most instructive and useful from the Committee view to evaluate the Penn Central on the basis of its impact on transportation policy in the United States. With this in mind, therefore, a special staff was assembled and the inquiry was begun.

The staff with the cooperation of the Penn Central Trustees in Bankruptcy examined the files of the Penn Central Transportation Company, extracted pertinent documents and assembled a file for use in drafting this report. This effort alone took approximately four months before the materials could be put in usable form. The ICC provided space for the special staff and for file materials which had been accumulated.

The special staff concentrated in the main on evaluating the Penn Central itself and the transportation rail situation in the Northeast quadrant of the United States. The review of the railroad industry generally (found in Part II of the report) was accomplished independently under a contract with a private consultant.

I do not necessarily support all of the findings or recommendations. In discussions with the staff, I indicated at early stages that it would not be particularly useful to the Committee to attempt to frame answers to transportation problems by dwelling upon violations of the law by corporate leaders. Such activities are already circumscribed by existing law. What the Committee needs to know is what changes in Government policy toward transportation are suggested by the current condition of the railroad industry, and most particularly the condition of the Penn Central Transportation Company.

The staff is to be commended for cutting away at a veil of confusion which has shrouded the Penn Central affair from the day of bankruptcy. I commend this document as part of a total effort toward understanding the job before Congress, the Administration and the Interstate Commerce Commission; the restoration of viability in rail transportation.

Sincerely yours,

VANCE HARTKE,
Chairman, Subcommittee on Surface Transportation.

CONTENTS

LIST OF CHARTS AND TABLES

PART 1

PART II

PART III

Appendix A

Appendix B

Appendix C

Appendix D

EXHIBITS

INTRODUCTION

The Pennsylvania Railroad was organized in 1846 primarily with local capital to protect the commercial interests of Philadelphia by maintaining trade channels through Pennsylvania. Founded largely on civic pride, this economic enterprise was in the center of the Philadelphia social establishment, a position it maintained throughout its history. The city's western suburbs were developed from railroad land adjacent to its mainline right-of-way. Its presidents right up through its last president, Stuart T. Saunders, were often politically skilled and influential beyond the borders of the State of Pennsylvania. The Pennsylvania, which grew to be the largest railroad in the United States, survived the depression intact and remained a substantial force in the business community of the Nation. Its corporate personality reflected its social standing and was characterized by gentility, tradition, and feelings of superiority toward other railroads. The company's management was traditionally divided into several, somewhat independent spheres of influence, each contending for Board approval of its policies, with the chief executive officer primarily mediating conflict rather than establishing his own independent course.

The character of the New York Central offers sharp contrast. It did not possess a secure connection to its community and to the past. Although also a railroad giant and a potent force in the Nation's commerce, it seemed in later years to be a lone wolf, cut off from its peers. Robert Young's takeover in 1954 disturbed its long association with the New York banks and drastically changed its management profile by bringing in, as president, Alfred Perlman who placed young college graduates into responsible positions, and encouraged innovation in railroad operations and marketing policies. The Central's chief executive played a dominant role in the company so that the Central was not composed of independent fiefdoms as was the Pennsylvania.

Despite the radically different backgrounds and philosophies of the two railroads, the late 1950's and early 1960's found them with very much in common, both having lost firm control over their own destinies. Plagued by declining markets and growing truck and water competition, both were financially exhausted. Accepting the prevailing view of merger as the panacea for the railroads' financial problems, they anxiously got into the merger parade, but even here they had lost control as others set the merger pace—first the C&O and B&O and then a combine under the Norfolk & Western which appeared to further threaten their security.

These earlier merger proposals left the Pennsylvania and New York Central with no other merger partners in the Northeast except each other. And the potentially stronger competition from the resulting roads made the Pennsylvania and New York Central fearful that they would not be able to survive alone.

Despite the essentially negative impetus for their merger, however, it was widely hailed as a forward step. Optimistic press agentry, confident assertions by merger architects, and financial analyses that concentrated only on the benefits expected from the merger resulted in the general belief that the Penn Central would not only be the Nation's largest railroad, but also a newly strengthened pillar of the Nation's economy. Stuart Saunders, generally given most of the credit for bringing the merger to pass, was named businessman of the year for 1968. The Penn Central's stock price shot up shortly after the merger to unrealistic heights. It appeared to many observers that the problems of the Northeast's major railroads had been solved.

Against this background it is not surprising that the Penn Central's collapse caught the Nation unaware. Warning signals of trouble had been suppressed or sugar coated. Its end approached with uncommon speed after the auspicious culmination of the merger.

Reality contrasted sharply with the rosy picture presented to the public and generally accepted by most observers. The ICC had presided over a complete reordering of the Northeastern railroad system in a short period of just six years. The debacle which would soon arise following the shotgun marriage of the Pennsylvania and the New York Central demonstrated, however, that a merged railroad is not necessarily superior to its parts. A combination of two weak, cash short railroads, with the smaller and even weaker New Haven added to it, produced a much larger but still weaker enterprise. So on June 21, 1970, two years after the merger, the ostensibly mighty Penn Central Transportation Company came to its ignominious end in a Federal bankruptcy court in Philadelphia.

Two large, proud and once robust companies were reduced to penury by a combination of adverse circumstances and internal weaknesses. They were at once similar and diverse—similar as to geographic sources of support; diverse as to philosophy, organization, approaches to railroading, and business in general. Accordingly they were both logical and unlikely merger partners. Financial difficulties both drove them together and made them unfit for each other. As would be expected of such a behemoth, the Penn Central's death throes were agonizing. After money borrowed from banks dried up, an attempt in May 1970 to raise $100 million through a public debt offering failed. In late May the Board forced out its Chairman (Stuart Saunders) and its chief financial officer (David Bevan) and the President (Paul Gorman) assumed complete charge. The company openly sought Federal government assistance under the Defense Production Act. The Secretary of Transportation responded by holding a number of "off the record" meetings with House and Senate leaders. However, the Chairmen of the House Banking and Currency Committee and the Senate Subcommittee on Surface Transportation, among others, were vocally skeptical of using existing statutes as a source of help and indicated their probable opposition to any new bills to provide assistance. Administration officials prepared to sign papers authorizing a loan guarantee by the Federal government of $200 million for the Penn Central but this approach was abandoned on Friday, June 19, in view of growing congressional opposition. After a last gasp effort on Saturday, June 20, failed to change views of key congressional leaders, the Penn Central filed a voluntary petition for railroad reorganization under section 77 of the Federal Bankruptcy Act. (Section 77 is a special section designed to keep bankrupt railroads operating while resolving the claims of creditors and equity investors.) Although the Penn Central's collapse shook the financial world, its failure was not the major transportation disaster expected by some. The element of surprise, together with the Penn Central's default on commercial paper and other obligations, reverberated throughout the financial community and required special action by Federal agencies to dampen the consequences. However, bankruptcy did not require shutting down the railroad. It continued to operate as well, if not better, under the supervision of the court as it had before.

The Senate Commerce Committee commenced hearings three days after the bankruptcy petition was filed to consider Administration proposed legislation which would have authorized the Federal government to guarantee $750 million in loans for the Penn Central Railroad. But more questions developed than could be answered immediately and the hearings continued through July and August, with two final days in November.[1]

The hearings produced a plethora of information about the Penn Central Railroad which hitherto had not been generally known: even by interested agencies of government such as the Interstate Commerce Commission and the Department of Transportation. Many members of the Committee found it difficult to comprehend that a corporation with assets of an estimated value between $4 billion and $7 billion could come to its financial end without gross culpability in either management or government. There was concern that the extensive nonrailroad holdings of the corporation not only failed to help the railroad but actually siphoned off funds which should have been used for improving the

[1] Hearings before Senate Committee on Commerce, Failing Railroads, Parts 1, 2, and 3, Serial No. 91–90, Ninety First Congress, Second Sess.

railroad's facilities and service. The diversification issue thus loomed large, and it was compounded by numerous indications of improprieties as well as possible conflicts of interest and law violations as the Committee exposed to public view the private investments of some corporate officers. These private ventures were intertwined with and otherwise closely involved with questionable ventures by the Penn Central Transportation Company, such as its investment in Executive Jet Aviation. Indications of important management objectives other than providing transportation service led to further investigations into management conduct by the House Banking and Currency Committee.[2] Meanwhile numerous private suits were filed against management, the board of directors, accountants, and others who could conceivably have played a part in the Penn Central's failure. The Securities and Exchange Commission investigated questions of insider trading, criminal actions were brought in Pennsylvania against the railroad, and the trustees in bankruptcy of the railroad brought their own action against the prior management. The ICC finally began an inquiry into the state of affairs, while the House Interstate and Foreign Commerce Committee staff considered the question of jurisdictional overlap and gaps between regulation by the ICC and the SEC.[3]

But while this flurry of activity was developing, the question of transportation service in the Northeast continued to plague the Congress. The Senate Commerce Committee rejected any thought of immediate aid to the Penn Central and continued to review the situation until the trustees of the railroad sought a hearing before the Committee in November 1970. The November hearings convinced Committee members that, without assistance from the Federal government, the Penn Central might indeed be forced to shut down its operations and stop providing essential rail services. The numerous conditions which the committee attached to a legislative proposal to aid the Penn Central were indicative of the Committee's reluctance to pour Federal assistance into what appeared to be an almost hopeless financial situation. But, on the other hand, the Penn Central was the nation's largest transportation company at that time, with some 20,000 miles of railroad spread throughout 16 states, the District of Columbia and two provinces in Canada. The area served included 55 percent of America's manufacturing plants and 60 percent of its manufacturing employees. It moved about 1 million tons of freight and 300,000 passengers every 24 hours. Twenty-one percent of all freight cars loaded in the United States passed over the Penn Central. Over 70 percent of the Penn Central's traffic involved other railroads. There was hardly a major commodity produced in the United States or imported that the Penn Central did not handle at one time or another. It was the leading railroad for the movement of automobiles, chemicals, metals and manufactured consumer products and the second largest grain hauler among the nation's rails. The Penn Central exclusively served 34 U.S. Army installations, depots, arsenals and plants, 13 naval bases, stations and centers, 12 Air Force bases and other defense facilities. It was at that time the largest single carrier of mail in the United States. According to the information available to the Committee, termination of operations by the Penn Central would have been a drastic blow to the economy—regionally and nationally. The Department of Transportation estimated that total economic activity in 17 Northeastern states would be reduced by 3 percent in the fifth week and 5 percent in the eighth week following termination of the Penn Central's services. For the nation as a whole there would be a 3 percent decrease in gross national product by the eighth week, unemployment would rise 5 percent in the eastern district and 3 percent nationally. These effects were regarded as unacceptable and hence, in the Committee's view, congressional action had to be taken.

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[2] See e.g. The Penn Central Failure and the Role of Financial Institutions, Part II, "Case Study of Penn Central Subsidiary," Executive Jet Aviation, Staff Report of the Committee on Banking and Currency, Dec. 21, 1970, U.S. House of Representatives, 91st Cong., 2d Sess.

[3] Inadequacies of Protections for Investors in Penn Central and Other ICC-Regulated Companies. Staff Study, Special Subcommittee on Investigations, Committee on Interstate and Foreign Commerce, House of Representatives, July 27, 1971, 92d Congress.

A bill was developed which would authorize a Federal guarantee of $125 million in private loans to railroads upon satisfaction of several conditions. The principal condition was that any recipient had to be in bankruptcy and therefore subject to the jurisdiction of a Federal court. The Committee stated in its report to the Senate: "The financial system that prevails in the United States recognizes that business failures will occur and so long as the Nation's entire financial structure is not seriously endangered such failure should be accepted. A competitive system will produce both successes and failures and theoretically within the proper framework the general public gains by having a choice available.

"The Committee is chary about setting any precedent for general relief to businesses which experience financial difficulties. Accordingly the legislation reported herewith is designed to let the laws of the marketplace pertain to railroads as to any other business until there is demonstrable evidence that terminaton of services by the railroad is imminent and that such termination will endanger the public welfare." The Committee went on to say that in its view, therefore, the railroad like any other business should be required to use the Bankruptcy Act.[4]

But in approving the legislation the Committee was aware that it was only emergency legislation, that it probably would not solve the dilemma of the Penn Central nor would it solve the massive transportation problems endemic to the Northeast. Subsequently the Chairman of the Surface Transportation Subcommittee, the Subcommittee which is directly concerned with surface transportation problems, proposed that the Committee commission a study to determine the cause of the Penn Central collapse, to isolate those factors which would be responsive to government action, and to propose solutions. Accordingly the Committee approved and in May 1971, the Senate authorized a special study of the Penn Central collapse to be carried out by the Commerce Committee. The Committee Chairman directed the Committee's Transportation Counsel to direct a special staff study. The Chairman of the Surface Transportation Subcommittee would oversee the staff efforts on behalf of the Committee.

The Committee's principal interest in this matter related to the quality of transportation service in the United States. It was determined therefore that the study should isolate and, insofar as practical, quantify the causes of the Penn Central collapse. It should place the Penn Central in perspective within the industry generally and it should place the asserted causes of bankruptcy in perspective. The study should reach conclusions and should propose solutions. It should not place undue emphasis on areas only incidentally of interest or areas which were being examined or had been examined by other government entities unless such additional examination was necessary because of the impact upon the provision of transportation services. As a consequence the staff did not devote substantial efforts to uncovering violations of the law after it became apparent that such violations were not major contributors to the railroad's collapse. In addition prosecutions at the State level had begun at an early date and Federal agencies have carried on their own inquiries. While not engaged in criminal investigation itself, the staff has endeavored to cooperate with law enforcement agencies at both the Federal and local level. Nor did the staff concentrate on the insider trading issue—the Securities and Exchange Commission having undertaken a thorough review of that area and apparently having taken steps to prosecute discovered violations. Similarly the study does not dwell on the misconduct of officers—having determined that, while reprehensible, misconduct was not an important cause of the collapse. From a strictly legislative viewpoint, the aforementioned areas, although of great interest and perhaps even some significance insofar as the railroad's collapse was concerned, were not likely to produce much guidance for improving government policy toward transportation.

Much of the information for the study was gathered directly from files of the Penn Central Transportation Company, from some creditors of that com-

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[4] See Senate Report 91–1510 of the 91st Congress accompanying S. 4595 which became P.L. 91–633 on January 8, 1971.

pany, from investment houses, from the Association of American Railroads and the rail industry generally, from the Securities and Exchange Commission, and from the Interstate Commerce Commission. The ICC made available vast amounts of information, including some very helpful verified statements by its investigative employees. It should be added that all of these sources and particularly the ICC, which provided working space for the special staff as well as information, have been most cooperative with the Committee staff.

The report resulting from this special study is divided into three major portions. Part I, a distillation of the fundamental forces underlying the Penn Central bankruptcy, begins with a piece entitled "Penn Central in Perspective" which states in as few words as possible the principle lessons and proposals supported by the report. The body of Part I starts with a look at the economic situation facing all transportation and in particular the Eastern railroads. The next chapter deals with Penn Central's Financial Performance. Then the chapter on Fiscal Policy describes the investment activities of the management in the years prior to the merger and during the two years of merger. While diversification is really a part of Fiscal Policy it is treated separately in its own chapter because of the great importance which has been attached to it. Then the railroad's operations are assessed. And finally, the Merger is reviewed. The final chapter of the analysis segment of Part I, entitled "An Integrated View," draws together in one place the general implications of the analysis. As an aid to the users of this report, immediately following the "Perspective" will be found the report's Findings organized to correspond with the structure of the "Evidence and Analysis" in Part I. The conclusions which follow the analysis were extracted from the Findings to answer questions about what happened to the Penn Central and who is to blame. Following that are the Policy Recommendations which seek to respond to the question of what the government should do about the problems identified by this study. Part II is entitled "American Railroads: Posture, Problems and Prospects." It is this work which provides a review of the rail industry generally and which supplies an industry-wide background for the Penn Central inquiry itself. Part III is composed of more detailed background studies which generally provided the basis for the Part I analysis.

An important objective of any study should be to critically review past actions. Often this process produces sharp criticism of conduct which at the time of performance, given the environment, might qualify as reasonable conduct in a court of law. This study does not purport to make any findings about legal culpability. Rather, it represents an effort to evaluate prior events in the light of today's standards for the purpose of improving future policy formulations. Hindsight is an invaluable tool for correcting past mistakes. But while using hindsight, the study group did strive for perspective in analyzing the various forces at work. And a determined effort was made to produce a balanced report, to provide practical guidelines for future action by the Congress, the Department of Transportation, the ICC, and the industry, in coping with the transportation crisis which now confronts the Northeastern part of the country and which may spread to other portions of the United States.

Part I

Penn Central Collapse: Perspective, Analysis, and Prescriptions

FOREWORD

Part I is intended to provide an analysis of the Penn Central and to extract lessons arising therefrom. It is the heart of the report. Several sections of Part I were drawn from the more detailed analyses found in Part III. Part I represents a distillation of the information available to the study group. The objective was to condense the relevant information as much as possible in Part I, leaving Part III for those interested in pursuing some of the individual subjects in more depth and using Part II to provide perspective for the Penn Central in a larger rail transport context.

Part I begins with a very brief synopsis, entitled "Perspective," designed to relate, in as few words as possible, the message transmitted by the Penn Central experience. The "Findings" immediately follow the synopsis; the "Findings" are essentially a list of principal facts arranged to correspond with the organization of the "Evidence and Analysis."

The "Analysis" begins with a review of the National and regional economic environment in which the Penn Central found itself. The next section "Financial Performance" describes the outward financial manifestations of the Penn Central's condition for the decade prior to bankruptcy.

It should be noted that much of the Financial Performance analysis and succeeding sections utilize "pro forma" data which is merely the combination of various data for convenient use. Usually it involved the combining of Pennsylvania Railroad and New York Central Railroad data prior to merger producing "pro forma" information about the Penn Central in premerger years.

The section entitled "Fiscal Policy" is an analysis of the company's financial management excluding diversification which was placed in a separate section immediately following "Fiscal Policy."

Following "Diversification" is the analysis of operations' management in the section entitled "Railroad Operations."

"Merger and the Road to Ruin" reviews the merger event and assigns its role in the demise.

"An Integrated View" seeks to draw together into one section the themes suggested by the prior analyses.

The "Conclusions," and "Policy Recommendations" refine the process further. The "Conclusions" are drawn from the "Findings" and the "Policy Recommendations" are the suggestions for future policy supported by the report.

Following each section are pertinent tables and charts supporting the text where necessary.

PENN CENTRAL IN PERSPECTIVE

The story of the Penn Central collapse has many facets and implications. But the most important conclusion of this report is that there was no singular reason for the Penn Central's financial failure. It will perhaps be disappointing to those expecting the root cause to be found in a litany of sordid events to learn that the railroad's failure cannot be written off as resulting from evil men's schemes. Rather the major contributors were much broader in scope: changing and more hostile environment in the Northeast, the declining condition of the national economy, management and industry response to those changes, and the failure of public policy toward transportation. The Penn Central's financial difficulties and the state of most other rail transportation in the Northeast flowed from a critical combination of those factors. The causes are to be found, then, in the failure of men, institutions and laws. The wrongdoers are being prosecuted and sued. But if we are to avoid a repetition and if the nation is to strengthen its transport system, changes must be made on many fronts; in laws, and institutions, as well as in the attitudes of men. This report makes a number of recommendations for such changes.

To assist in quantifying the contributors to the failure of the Penn Central, the following is offered to show the effect of various factors on available cash:

PENN CENTRAL TRANSPORTATION CO.—CONDENSED COMPARATIVE STATEMENT FOR THE PERIOD 1960–69

[In millions] [1]

	1960–69 (millions)	Percentage
Railway operating revenues	$15, 210. 8	100. 0
Less: Operating expenses	12, 478. 9	82. 0
Net revenues from railway operations	2, 731. 9	18. 0
Less: Joint facility rents, taxes, etc	2, 408. 2	15. 8
Net railway operating income	323. 7	2. 2
Plus: Other income	789. 0	5. 2
Less: Other expenses	103. 8	. 8
Income available for fixed charges	1, 008. 9	6. 6
Fixed charges	858. 5	5. 6
Net income	150. 4	1. 0

[1] 1960–67 pro forma.

Selected factors showing influence on cash for the period 1960–69

		In thousands
Dividend payments (1960–69)		$307, 111. 2
Passenger losses—Solely related[1] (1964–70) (On a fully allocated basis, the losses were $609,127.)		198, 451. 2
Excessive bad debt expense post-merger		31, 511. 9
Inter-territorial division settlement		11, 550. 1
Merger-related expenses:		
Capital improvements	$90, 200. 0	
Excessive per diem	15, 000. 0	
Labor protection	64, 600. 0	
Purchases	18, 600. 0	
New Haven inclusion:		
Rehabilitation costs	31, 000. 0	
Advances	14, 000. 0	
Total, merger-related expenses	233, 400. 0	
Subtotal		782, 024. 4
Investments in subsidiaries and affiliates—Cash outlay only[2]		203, 203. 0
Total		985, 227. 3
Interest[3] expense on dividends paid (1963–69)		$67, 673. 0
Interest[3] expense on cash investment in subsidiaries		56, 903. 3
Interest cost on borrowings necessitated by increase in accounts receivable (1968–June 1970)		3, 554. 6
		128, 132. 9
Total		1, 113, 360. 2

[1] Includes New York, New Haven and Hartford RR. for 1968–70.

[2] Primarily by the Pennsylvania Co. Net cash outflow for diversification from 1963 through 1970 was approximately $41 million.

[3] Imputed interest on cash paid out.

Also of interest is the following general table showing the source of funds and the application of funds for the Penn Central over the period 1960 through 1969:

PENN CENTRAL TRANSPORTATION CO. (COMPANY ONLY)

STATEMENT OF SOURCES AND APPLICATIONS OF FUNDS, FOR PERIODS ENDED DEC. 31, 1960 TO DEC. 31, 1969 [1]

[In thousands of dollars]

	1960–69 totals
Sources:	
Net income (loss)	149, 900
Plus depreciation	951, 700
Less identified noncash transactions	(132, 000)
Total	969, 600
Increase in capital stock (principally options)	8, 600
Sale of capital assets	343, 300
Sale of investments and miscellaneous properties	322, 800
Sale of investments to Pennsylvania Co	29, 500
Equipment financing:	
CSA	670, 900
ETC	117, 100
Leasing	546, 900
Total equipment financing	1, 334, 900
Other borrowings and advances	799, 100
Total sources	3, 807, 800

	1960–69 totals
Applications of funds:	
Dividends	307, 100
Capital expenditures:	
Road	571, 900
Equipment	1, 056, 500
Leasing	546, 900
Total	2, 715, 300
Other capital expenditures	36, 000
Debt reduction	1, 141, 400
Investments and advances	5, 800
Increase in special funds, expenditures charged to merger reserve	36, 300
Miscellaneous	31, 400
Total applications	3, 733, 300
Increase (decrease) in net working capital	(81, 700)

[1] For more complete table, see Appendix D, Exhibit 81, p. 748.

The lessons for policy are particularly pressing because many of the factors that contributed to the bankruptcy of the Penn Central are at work in other parts of the Nation's rail system. Rail service is seriously impaired throughout the East and is less than adequate in other sections as well. It is important to keep in mind, however, that the definition of the railroad problem is commonly oversimplified. It is in reality highly complex, with manifestations varying in character and severity among regions and railroads. Examining the railroad system in the aggregate hides the significant relationships. For some railroads, traffic is growing steadily; for others, the outlook is bleak. Despite the strength of some roads, the deficiencies of the system and the Penn-Central experience offer a stern warning with far reaching lessons for carriers, transportation users, taxpayers, and government.

It is unlikely, however, that mere modification of traditional policies would provide a setting conducive to a fiscally and operationally viable system. Specifically, long-neglected problems such as functional obsolescence of the rail plant attributable to decades of fiscal starvation, locational obsolescence attributable to the dynamics of the economy, and archaic management attitudes, must be dealt with. Effective treatment requires sharp changes in the premises of public policy and organic restructuring of the industry.

The challenge is to devise a combination of public and private programs that will insure a railroad system appropriate for present and future transport markets and public needs. Although much can be done by individual carriers to improve their efficiency and provide more reliable service, the industry as a whole must willingly seek to enhance individual efforts and, more importantly, to improve system performance. We cannot lose sight of the fact that the railroads must function as a system; one railroad cannot function in isolation from others. Beyond private remedies, the answer appears to be in a reasoned systems' approach identifying and addressing fundamental system deficiencies, taking into consideration social, environmental and economic factors.

The recommendations found at the end of Part I of this report begin with the need to improve public disclosure of financial, physical, and operating conditions of railroads.

Improved identification of problems and the formulation of policy can occur if the Department of Transportation helps to monitor the rail system, and determines the nation's needs for rail service; and if the executive branch focuses attention on the illness. The government's involvement in rail affairs must begin before facilities deteriorate to the point where the public interest is adversely affected.

While protecting the rights of protagonists, the Commission must develop guidelines for speedier decision-making on issues involving diversification, rates, abandonment, and merger policy.

Service failures, maintenance neglect and freight car utilization are other matters specifically requiring more attention by government. Government assistance should be addressed specifically to the needs of the public and transport users for better service.

The Penn Central and most other railroads in the Northeast appear to have declined to the point where drastic action is necessary. Various suggestions have been made. One suggestion of great interest proposes the establishment of a Northeastern Transportation Authority with appropriate local, State, and Federal representation. The Authority would determine what is necessary in terms of rail service for the Northeast. If it subsequently found that such service could not be provided by the existing transportation network, given its financial problems, then either the Authority or a quasi public corporation would take over the operating authority of all bankrupt railroads in the Northeast, issuing government guaranteed debentures to the trustees in bankruptcy, and placing stock in escrow for later sale to the public if and when feasible. Free from investor imposed constraints, the authority would have sufficient power to improve the service capability from a systems vantage point and, hopefully, would eventually restore a revitalized rail system to private ownership and control at little cost to the Federal government.

FINDINGS

Environmental Conditions

The market and general economic environment for the Pennsylvania and New York Central Railroad was particularly hostile and grew increasingly so during the 1960's and throughout the merger gestation period.

(*1*) *Changing nature of the national economy*

During the 1960's the role of transportation in the American economy, while still expanding in absolute terms, deteriorated somewhat in a reflection of lessened emphasis on goods production. Freight transportation is concerned with the movement of physical things such as minerals, agricultural products and manufactured goods which for many years were at the core of domestic economic activity. Recently, however, the services, finance, trade and government sectors of the economy have been growing most rapidly. In terms of the share of the Gross National Product they represent, agriculture, mining and nondurable goods have begun to diminish while the share represented by the services, finance and trade categories have expanded considerably. From a transport standpoint, these "service" sectors generate relatively little demand for freight transportation. Environmental and related social considerations have also had an affect on transportation. For example, coal has come under general disfavor as a source of energy (although recent fuel supply problems promise to revise the trend outside the Northeast), hurting the railroads as a group. The impact has been most severe in the case of restrictions on higher sulfur content coal, which is the kind of coal mined in most of the coal fields served by the Penn Central. In view of these trends it is not surprising to find that freight transport indicia have been shrinking in relation to aggregate economic expansion.

(*2*) *Technological changes*

The shifts in the composition of the economy have been accompanied by changes in technology. The use of lighter weight materials, for example, has reduced the demand for transportation capable of moving large, heavy materials. There has been a general trend toward locating factories and other production facilities closer to consuming markets, further reducing the demand for transportation. Coal, once burned almost entirely at electric generating stations located in the using market after being hauled by rail from the mine, is now consumed in large quantities for electric power generation at the minehead.

(*3*) *Cyclical economic patterns*

The cyclical pattern of the economy has a pronounced impact on transportation and especially on the railroads. Rail traffic closely tracks the ups and downs of the economy. During the 1960's this had acute significance for all the railroads and particularly for the Penn Central in the decade's last years. Recessions took place in the beginning of the decade, 1960 to 1961, and at the end from 1968 (when the Penn Central merger was consummated) until 1970 (when the Penn Central petitioned for bankruptcy). The almost continuous decline of the economy at merger time set the stage for hard times for the new Penn Central.

(*4*) *Uneven impact of change on the modes*

The forces of change have permitted other modes of transportation to gain ground on railroads. The rail share of intercity freight traffic has been substantially reduced, to the benefit of the other modes—trucks (with their greatest penetration coming in general commodities), barges, and pipelines (delivering substantial amounts of bulk traffic). In 1960 railroads accounted for

44 percent of the nation's intercity freight transportation, but by 1969 the rail share slipped to 41 percent. The rail share of freight revenues declined from 28 percent to 22 percent. By contrast the trucks increased their revenue sharply during this period, doubling their tonnage and doing even better in their profits.

(5) Northeast region

In the Penn Central region these factors were an even greater negative force. The Penn Central territory has lost ground relative to the rest of the nation. Its percentage of the population has dropped since 1950, as has its share of the nation's personal income. Even more pronounced is the decline in manufacturing (from 65 percent of the total in 1950 to 54 percent in 1969). In absolute terms of course, States making up the Penn Central territory continued to bulk large in the national economy. But the region's relative rate of expansion clearly lagged behind most other areas. To see how all these forces have come together and affected the Penn Central it is helpful to look at the key traffic sectors—coal, manufactured goods, and smaller shipment movements.

Coal—By 1970, only 15 percent of the Penn Central's revenue was derived from the transportation of coal as coal production in the region dropped from 71 percent in 1957 to 62 percent in 1970 of the total coal produced in the nation and there was an increased tendency for mine head use of coal (by 1970 nearly three times as much coal was being consumed for power generation at the mine head than was being transported by rail). At the same time the Eastern market was declining, Penn Central's share of the market dropped even more (while Eastern roads generally reported a 5 percent increase in coal revenue between 1965 and 1970, Penn Central coal revenue was off more than 11 percent).

Manufactured goods traffic—The railroads lost ground in transporting high rated manufactured goods to other modes, especially to the trucks. In the Eastern district the rail share dropped by about 3 percent between 1963 and 1967 while in New York City, for example, the trucks increased their share from 50 percent to 73 percent. Of significance here too are the railroads' successful efforts to regain automobile transport traffic which had been lost in the 1940's and 1950's. Their fight to regain this traffic in the early 1960's caused tonnage to rise by 164 percent, while revenue, revealing the downward rate adjustment that had been put into effect, increased by 93 percent. The Eastern roads did better than the industry with this traffic. However, the Penn Central, while improving, did not do as well as the other Eastern roads. The resurgence of auto traffic suggests that railroads are capable of highly effective competition in higher valued manufactured goods traffic.

Small shipment traffic—In the late 1940's and early 1950's, railroads virtually abandoned hauling goods in less than carload lots, and today handle only a very inconsequential volume of such shipments. These small parcels (50 to 10,000 pound category) represent 95 percent of all shipments by for hire truckers. In 1970, they represented about 79 million tons of freight. This is high value freight with high rates and high yields. With its coal traffic down sharply and with the loss of substantial manufactured goods traffic to the trucks, the Penn Central (and it was not alone in this respect) was caught in pincers. Railroads are slowly making an effort to reenter this market with TOFC (trailer on flat car) or COFC (container on flat car) service.

(6) Interterritorial divisions

When two or more railroads participate in a joint rate shipment there must be a division of the resulting revenue. Considering that billions of dollars ($4 billion in 1969) are subject to divisions each year, it becomes apparent that very

small percentage shifts in the share to be allocated are of substantial economic importance. The Northeastern (Official Territory) carriers have in recent years argued for readjustments. The Penn Central alone claims that division adjustments could increase its revenues by $46 million. Major division cases are hotly contested affecting as they do the economic condition of every region in the country. Equitable resolution of such disputes are important but at the same time difficult to achieve.

Penn Central Financial Performance

The hostile environment was reflected in extreme financial stringency for the Penn Central, with the railroad operations incurring chronic deficits as traffic dropped off and expenses shot up even while revenues and rates increased.

(7) *Revenues*

Operating revenues for both the New York Central and the Pennsylvania Railroad were generally unfavorable in the late 1950's, reaching a low point in 1961. After some hesitation in 1961 to 1963, their combined revenue advanced rather firmly through 1966. The favorable revenue trends through 1966 resulted entirely from increases in volume; significantly this increased revenue occurred with no important change in haul patterns and with reduced rates. After 1966 modest revenue growth was achieved despite a consistent drop in traffic volume (a force which cannot long be countered by compensating factors). Post 1966 revenue growth for the Penn Central partners was similar, but lagged far behind the performance of other railroads in the East. Other railroads' traffic revived after the 1966–1967 downturn while Penn Central traffic continued to fall.

(8) *Costs*

The generally upward revenue movement during the 1960's suggests that the company was not done in by a revenue collapse in absolute terms. It appears that rising costs were more damaging than softening revenues since operating expense for 1969 and 1970 was up about $400 million. The operating ratio (ratio of expenses to revenues) of the partners declined steadily through 1966 (to 78.8) and thereafter rose sharply going completely out of sight (to 92.1) after merger. The increased expenses came largely from rentals which jumped dramatically from 1964 to 1970. During the same period, fixed charges (interest payments) rose substantially. This presented a particularly lethal combination. Over the entire 1958 to 1970 period under review, the railroads generated positive net railroad operating income of only $164.5 million (removal of the merger period increases this by some $300 million) and incurred fixed charges of $1,180.5 million.

Fiscal Policy

Financial stringency was a cornerstone of fiscal policy. For the Pennsylvania and later the Penn Central it was matched by concern for credit standing. The resulting ad hoc policy of compromising conflict presided over a deteriorating physical plant while earnings were overstated and excessive dividends continued to be paid.

(9) *Constraints*

There were numerous constraints on the railroad's fiscal policy. The most important were: (1) inherited—fixed charges (interest) and capital structure

(debt) from postwar investments; (2) merger induced—agreement to limit the amount of debt increase (initially $100 million, later $195 million), and agreement to maintain stock ratio between the companies of 1.3 (NYC) to 1 (PRR) made more significant by the excessive delay in consummating the merger; (3) outside factors—severely limited earnings potential of the two companies, restricting range of investments and means of financing, financial market conditions, financial market assessments of credit worthiness and security values, and finally stockholder pressure.

(10) Investment programs and patterns

During World War II these railroads along with many others were used very intensively with inadequate repair and replacements, leading to the deterioration of roadway and equipment. The two companies fell behind the system as a whole and individual companies throughout the country in rehabilitating and improving the physical plant. For the 20 year period prior to merger the Pennsylvania Railroad invested $2.19 billion in the plant and the New York Central $1.45 billion or a grand total of $3.6 billion. During the years 1959–1967 over $1.5 billion was put back into the two companies that were able to generate only $472.5 million of net railway operating income. (This investment represented nearly 10 times the amount put into diversification during the period 1963–1970.) As a percentage of revenues the record was far below the achievement of many other major roads including Penn Central's regional neighbors, Norfolk and Western and Chesapeake and Ohio as well as the Southern Pacific and even the Chicago and Northwestern. For maintenance expenditures the pattern shows little change over the 20 years prior to 1968, varying between 41 percent and 46 percent of the total investment. After merger the capital investment program remained modest, but extraordinary maintenance expenditures increased from $421 million in 1967 to $551 million in 1970. Coupled with this were miscalculations in merger-related capital expenditures which were projected to reach a total of $74.7 million over four years but were $90.2 million in just the first two years.

(11) Investment Policy

Investments for the Pennsylvania, particularly, and later the Penn Central, reflected policies which attempted to compromise the conflicting pressures and criteria imposed by concern for fiscal measures and fiscal performance to support the company's credit standing and those imposed by operating requirements for plant improvement. Credit standing was also of prime importance to stockholders not wishing to see further decline in stock prices. In 1963 the Pennsylvania Railroad financial officer enunciated a policy allowing increased capital investment in the railroad only if it produced a 30 percent return as a minimum or a $50 million operating profit. Operations officers argued the need for more plant investment and complained that the financial officers were more concerned about non-railroad investments or a decrease in "our Moody's rating" than in improving railroad operation. By 1967, just prior to the merger, the financial officer had no road capital budget for the ensuing year and the status of the equipment budget was still up in the air. In addition, a stop had been ordered to all future railroad projects that did not show a 50 percent return on investment unless required for safety or for industrial development purposes. It is also important to note the influence of ICC accounting rules which actually provide a deterrent to major maintenance expenditures in track and roadbed requiring the bulk of such expenditures to be charged to expense when made. (At the same time it results in overstatement of net income because depreciation is not allowed on track and roadbed.) (See also finding 16.)

(12) Investment Policy Evaluation

Investment patterns showed the absence of any coherent capital budgeting process. Instead, the avowed policy of the Pennsylvania Railroad was "middle of the road," shifting as pressures changed. It might be described as a non-policy with no consistent corporate goals, or even an ad hoc system of compromising conflict. While the railroad investment program for 1964 through 1966

was considered a failure by the financing officer, questions arise about the rationale of the criteria and the stringent payoff period expected for rail investment, but not for non-rail investments. In the final analysis it is difficult to evaluate the budgeting process because of the absence of any clearly defined goals. Furthermore, the system had no integrity, no one believed estimates, and measurements of performance were of doubtful utility as evidenced by the financial officer's questionable guidelines.

(13) Capital Structure and Debt Burden

There was a major postwar buildup in debt, a debt reduction program to 1964, and then a Pennsylvania buildup in conjunction with a Central plateau. Total increase between 1964 and bankruptcy was over $700 million (to $721 million for the Pennsylvania, and $666 million for the Central). Since railroad earnings tend to be volatile, a safety margin is needed for successful debt management to insure annual income sufficient to cover fixed charges and to provide flow of funds, including depreciation accruals, to meet maturities. Not having these essentials, debt management for the Pennsylvania and the Central was precarious.

With heavy maturities coming due ($52.9 million in 1965 and $84.7 million in 1968) the Pennsylvania had big problems. The Central escaped the debt problem for a while by holding down capital expenditures and deferring maturities until the 1970's. The Pennsylvania expected relief under the merger because of the Central's favorable debt structure which made the combined capitalization superior to either one individually and quite acceptable to investment analysts. The programs of debt reduction for both companies reflected expectations that future revenues would be inadequate to meet obligations, and were accomplished by paring down capital commitments to rail operations and greatly curtailing maintenance.

(14) Equipment Financing

Equipment financing constitutes the major component of any railroad's plant investment. Such investment is explicitly encouraged by the more ready availability of investment funds because of more favorable financing methods. Of the three general methods of financing (sale of equipment trust certificates, conditional sales financing, and leasing), leasing requires a smaller down payment and leaves title in the lessor giving the lessor greater security. These factors make leasing attractive to railroads with financial difficulties. Because the lease payment is treated as an operating expense rather than a fixed charge (interest payment) it can give the illusion of a reduction in the railroads' long term debt and fixed charges. The Pennsylvania Railroad had begun concentrating on leasing as early as 1957 and the New York Central used leasing starting in 1962. After 1962, leasing provided a means to circumvent the merger agreement on debt limitation and was therefore important to the merger partners. A corollary effort was the capitalization of major overhaul expenses. The ICC Bureau of Accounts has argued that even when rebuilding is involved, capitalization is improper and the costs involved should be written off as maintenance expenses for the year of rebuilding. Nevertheless, in years just prior to merger the Pennsylvania Railroad shifted to a capitalization basis which, in the short run at least, reduced reported maintenance expenses and thus increased reported net income. Coupled with a program of selling cars to "straw parties" and leasing them back, the railroad showed smaller cash drains in the year of repair although it might mean larger cash drains in following years. It also permitted the Pennsylvania Railroad to use the investment tax credit indirectly through the third parties which repaired the equipment and leased it back.

(15) Postmerger Fiscal Policy

Like other railroads the Penn Central partners rarely used equity financing, even in those instances where it was most certainly suggested by the circumstance. Soon after the merger was consummated and a period of rising interest rates and tight money was at hand, the Penn Central management, in great need of financial assistance, went the route of short term debt, putting it in greater jeopardy than if long-term financing had been arranged at the time of

the merger. But if ever equity financing were appropriate, it was at the time of the merger when the price earnings ratio was very high because of expectations about merger savings. Also a stock offering at that time would have been less expensive than usual. By providing the railroad with substantial funds and not increasing debt it would have given the railroad a much needed margin of safety. There seems to be no good reason why a stock offering was not made in this particular instance, nor why railroads shun stock offerings in general.

(*16*) *Accounting Practice and Policy*

The existing ICC position on "betterment accounting," deferred income taxes, accounting of investments in subsidiaries, and financial disclosure requirements does not in all cases reflect the increased complexity of the major common carriers' operations and the need for more relevant financial information by analysts and investors. The ICC's regulations lack precise requirements for certification of financial statements by independent accountants and standardized disclosure requirements for prospectuses. These regulations fail to obviate the sort of loose accounting practices evinced by the Penn Central Company's treatment of transactions designed primarily to inflate reported income on both a consolidated and nonconsolidated basis. (See also finding 11.)

(*17*) *Earnings Maximization*

Earnings maximization, or earnings inflation, was employed by the Pennsylvania Railroad and the Penn Central (it was not pursued extensively by the Central). This technique was not concerned with the realities of income or cash flow, but was an effort to pretend that earnings were larger than they really were by inflating them. Earnings maximization, a practice in deteriorating companies, was pushed to extremes by the desire of management to protect the 1.3 to 1 stock exchange ratio agreed upon in 1962. If the New York Central is relative value were increased, the share of earnings going to former Pennsylvania Railroad shareholders would be less and renegotiation caused by an altered earnings picture might delay the merger. The policy was continued after merger, even though the ratio was no longer relevant, reportedly to maintain the credit position of the railroad. As the practice continued there developed less and less relation between cash flow and reported income. Devices used included requiring subsidiaries to inflate reported earnings and declare large dividends; reporting as much income as possible as ordinary rather than extraordinary; restricting maintenance and capital expenditure budgets; capitalizing equipment refurbishing (as described in finding 14); and treating as many ordinary expenses as possible as "extraordinary expenses." These practices did not generate any new cash; they only seemed to. Although the Penn Central was an illiquid company where cash management would seem to be a major area of management concern, the generation of cash was secondary to the attempt to inflate, and thus distort, reported net. Accounting theory, which stresses conservatism and consistency, was either ignored or adhered to solely when consistent with the principle objective of delusion.

(*18*) *Dividends Policy*

While dividend payments for all Class I railroads are probably too high, dividends paid by the Pennsylvania Railroad and the New York Central in the 1960–1967 period were extraordinarily high. Starting in 1962 (when the merger agreement required maintenance of the 1.3 ratio for dividend payments) the two railroads actually increased their dividends each year, very carefully maintaining the 1.3 ratio. From 1960 through 1969, dividends totaled \$307.5 million (\$282 million of which was paid after 1963.) After merger, dividends paid in 1968 were \$55.4 million while the Penn Central Railroad lost \$2.8 million. The 1969 dividends were \$43.4 million while the railroad had a deficit of \$82.8 million and a consolidated income of \$4.4 million. Considering the severe financial straits, Penn Central's management evidenced a cavalier attitude toward the declaration of dividends. Penn Central management later argued that the dividends kept up the price of stock and gave the railroad a better credit rating. But it is difficult to justify efforts to prop up stock prices in a crisis when no stock issue was ever contemplated. It is also important to note

that since dividends were greater than available cash resources, the Penn Central had to borrow money to pay them. This meant higher interest costs in terms of millions of dollars more than the railroad needed to pay. Such high dividends could not be justified. Any favorable consideration the Penn Central might have received as a result of its steady dividend payments could hardly have offset the cash drain of more than $130 million in dividends and related interest payments after the merger.

Diversification

A specialized aspect of fiscal policy, diversification, resulted in a net cash drain which, while relatively small, could be ill afforded at the time. As part of the overall fiscal policy, it contributed to the company's illusory credit standing.

(*19*) *Cash Flow*

Historically both the Pennsylvania Railroad and the New York Central had substantial interests in nonrailroad investments. The diversification program of interest here and which has generated so much discussion began in 1963 shortly after the Pennsylvania's sale of its large Norfolk and Western railroad holdings became imminent. Of particular interest, because we are concerned with illiquid roads, is the cash flow involved. While the total acquisitions were valued at $320 million the cash outlay was $203.2 million. Of that the Pennsylvania Railroad paid out $172.1 million, the Central $21.4 million, and the Penn Central $9.8 million. While the "changing and novel" reporting procedures, which substantially separated accounting entries from reality and cash flows, indicated substantial return on investment, if measured in cash terms only the average cash return was about 5.5 percent. After offsetting the cash received from the Norfolk and Western and Long Island liquidations, it reduces to a final net *outflow* of $41.8 million. This is an important sum in absolute terms but not of great significance by itself. As noted earlier, from 1959 through 1967 $1.5 billion was reinvested in the railroad; nearly 10 times the amount put into diversification during 1963 through 1970.

(*20*) *Policy Implications*

Of perhaps greatest relevance, keeping in mind the cash needs of the railroad, is the inappropriate nature of the diversification investments of this 1963–1970 period. Investments in real estate ventures such as Great Southwest Corporation, Arvida, and Macco Realty required external financing from Penn Central because funds were tied up in unsold properties for future development and because of a high rate of receivables, principally in the form of second trust notes. These absorbed all funds generated internally and permitted small dividends at best. The infamous Executive Jet Aviation investment gave very little hope of an immediate or even near term return on investment in either reportable earnings or, more certainly, in cash dividends. Like the real estate companies acquired, EJA was a poor investment in light of the railroad needs. The financial officer's stringent payoff requirements for railroad investments were not applied to non-rail investments. The major contribution of the non-rail investments was the dubious one of helping to distort earnings made possible by paper profits generated in real estate transactions.

Rail Operations

Fiscal policy conditioned other aspects of management performance, contributing to the railroad's poor physical condition and low quality of service. Management utilization of existing resources also contributed to poor performance, demonstrating a lack of mutual supportive relationships among critical policy areas embracing production, pricing, marketing, and financing. Differences in managerial approaches did not yield noticeably different results.

(*21*) *Relative management performance*

Similarity in revenue patterns indicates that any differences in the two companies—in philosophy or policy—were not great enough to significantly

influence operating revenue trends; both railroads were apparently influenced far more by other common forces.

(*22*) *Constraints on operations*

For the merger partners it is vital in evaluating management decisions to recognize that the Penn Central and its predecessor companies were in a depressed industry in a region of the country where economic expansion had slowed. Other restrictions affecting the railroads included rate regulation, relations with other companies in the industry, and customer influence, particularly large customers. Restrictions on the abandonment of service, often pointed to as a major constraint, are of uncertain importance. The savings claimed are not particularly impressive and it appears that several factors currently not quantified may deserve greater attention. The fruits of the fiscal policy (another constraint on operations) are found in the *relatively small* amounts of money which had been put into the plant in capital and maintenance as measured by other railroads. But in terms of available resources, performance was no worse than mediocre in recent years in that capital expenditures as a percent of operating revenues approximated the national average. Still, the investment by both railroads in freight cars, as measured by freight car units in operation, declined in the 20 years prior to the merger. By 1966 the New York Central had a rent deficit (interline payments) increase by 109 percent while the Pennsylvania Railroad had a whopping 367 percent. So the railroads were saving capital expenditures in the short run but were creating much greater expense in the long run and were endangering service quality.

(*23*) *Physical condition*

The low rate of physical replacement had unfavorable operating consequences. Pennsylvania Railroad had an outlandish accident rate, and incredible amounts of track subject to slow orders. The New York Central's accident rate and slow order track also increased but was well below the regional level. The condition of the railroads' equipment was also very poor although the Pennsylvania's was much the worse of the two (even though its cars were used less intensively). A bad order ratio of 5 percent is regarded as the maximum tolerable limit. The Central did reduce its ratio from 10.7 percent in 1960 to 3.5 percent by 1967. The Pennsylvania's was over 15 percent in 1963 and still 9.0 percent in 1967. Locomotives were also in bad condition. The Pennsylvania at one time had nearly one of every five locomotives in unserviceable condition. While the Pennsylvania Railroad spent more money for equipment maintenance than New York Central, it had a lower per car average, except for locomotives, than the Central.

The Penn Central companies were fairly representative in terms of their plant maintenance and investment outlays relative to net railway operating income. They lagged further behind, however, in terms of commitments relative to physical plant units. As a result their composite and merged plants were not adequately supported, as was manifested by unfavorable operating consequences. In absolute amounts and in terms of available net income the Pennsylvania outdid its partner in plant support, particularly with respect to equipment, which compared favorably with other railroads. But it was not successful in producing results visible from these comparisons. In slighting roadway and favoring equipment, the Pennsylvania seems to have gotten the worst of both ends of the bargain. It gained no real payoff in the equipment commitment but suffered directly and severely from the roadway neglect. The operating consequences in unserviceable equipment and unsafe track hit with particular severity.

(*24*) *Labor utilization*

Available indicators point to relatively inefficient labor utilization by the two companies that got even further out of control after the merger. Since wage rates are relatively standardized, high labor costs relative to other railroads are a symptom of an unfavorable labor mix or inefficient utilization. Because the Penn Central partners ran significantly behind other railroads in their region in productivity there is indication that labor control was inef-

fective. Gross ton miles per employee was very unfavorable. Gross ton miles per dollar of compensation also paints a dismal picture. Indications are that the Penn Central partners had an employee mix that was relatively expensive and becoming increasingly so. The Penn Central had a superior performance for compensation per service hour over compensation for employees, suggesting that the unfavorable elements were associated with employees who were not operating trains. There is no question that the wage bill for the Penn Central was and is quite high, representing more than one-half its gross operating revenue. While there was some inflation of wage cost at merger times, apparently because of the recall of previously furloughed employees, seriously unfavorable patterns solidified well before then. The cause is largely to be found in high employment ratio per gross ton mile, or in relatively high salaries of supervisory personnel. Evidence of employment excesses is suggested by the sharp post bankruptcy declines and by prebankruptcy management statements about force reductions that it expected to accomplish. It appears that there was really labor slippage primarily attributable to inadequate management control. It must be noted here, however, that the Penn Central partners provided nearly 40 percent of the rail passenger service in the United States prior to the time when AMTRAK (the National Rail Passenger Corporation) assumed control in 1971. Since passenger service tends to be much more labor intensive than freight service, this may account for much of the unfavorable situation for the Penn Central relative to other railroads.

(25) *Physical performance*

The Pennsylvania Railroad enjoyed higher traffic densities than its companion and ranked in the middle of comparison railroads. On the basis of traffic density, good equipment utilization would be expected. However the Pennsylvania ran behind the New York Central in equipment utilization and both fell well below the standard of other railroads. Transferring the measurements to monetary terms, the transportation ratios (measuring transportation expenses as a percentage of rail operating revenue) of the Penn Central companies were higher than their neighbors (interestingly Pennsylvania maintained a consistently lower ratio than the Central). The Penn Central performed poorly. In assessing management performance, however, comparisons between the partners are significant.

(26) *Pricing*

Pricing in the railroad industry has always been difficult. One primary reason is the industry's inability to precisely determine and allocate cost. Another is that no carrier or set of carriers controls a critical collection of the pieces that go into making up the railroad rate structures. And a change in one collection inevitably has serious ramifications in others. This suggests that any form of rate structure adjustment will require a joint industry-government effort. The railroads often face a dilemma in making a case for rate increases. The conflict is personified by the Penn Central partners. The Pennsylvania Railroad felt that across the board percentage rate increases were essential, not so much because of the merits of such an approach, but because more railroads support that approach. Reaching industry agreement on a commodity by commodity basis would delay presentation of the proposal to the Commission. The New York Central took an adamant position in favor of restructuring rates and proposing selective decreases as well as increases. The Central finally accepted the view that it was impossible to get what was best and decided to go along with the other railroads and at least get what was possible, with the understanding that the Pennsylvania and other roads would support a rate restructuring program at a later separate proceeding. The industry through 1971 continued to seek, and the Commission continued to approve, across the board increases.

(27) *Marketing and cost information*

In attempting to develop an innovative approach to marketing, the New York Central used available cost data. How strong a foundation the data provided has been questioned because such data was based upon ICC formulas which have been criticized in some circles. Pennsylvania, on the other hand,

traditionally gave little emphasis to individual commodity profitability. Moving from the traditional economic thesis of high fixed costs for railroads, the Pennsylvania believed railroads should be primarily concerned with increasing traffic volumes to reduce unit costs and thereby assure profitability. It was oriented to the steel industry and profitable bulk commodities like coal. The merged road had poor information as to its costs: A top traffic official of the merged company recognized after merger that "there is no question about the shortcomings of our existing cost data."

(28) Marketing techniques

The Pennsylvania Railroad and the New York Central had dramatically different approaches to marketing. At the Pennsylvania marketing was a staff function while at the New York Central it carried line authority. The differences were deep seated and considered critical by the participants. The New York Central commodity marketing oriented approach reflected industrial marketing practices and was explicitly designed to replace the traditional practices epitomized by the Pennsylvania Railroad approach. Indications are that merits of the two approaches are sufficiently mixed and other forces so strong that marketing innovations did not seem to be a critical determinant of the financial fate of the railroads. The Penn Central needed a *unified* policy approach of either type to avoid the organizational paralysis that set in.

(29) Quality of service

One of the most difficult measures of management performance is the quality of the service that a railroad provides to its shippers. Typically, shippers' satisfaction with carrier service is reflected in complaints filed with the carrier. If there are not improvements to correct serious deficiencies, the shipper may turn to competitive for-hire modes of transportation or supply his own transportation in the form of truck or barge service. Serious deficiencies include such things as car shortages, uncooperative and inefficient labor, excessive transit times, bad ordered cars, poor switching service, inadequate road bed maintenance and lack of motor power. Prior to bankruptcy Penn Central was a favorite target of shipper complaints.

(30) Management goals and mutual support

A prime failure of management was the nonexistence of overriding corporate goals and the lack of any organized effort to achieve goals. The separate units of the corporation in some cases had mutually exclusive objectives. The only commonly supported objective seemed to be the merger. Without for the moment considering the myriad problems associated with the merger, it can be said that management of the Penn Central seemed to show a lack of coordination and a lack of mutual support between the major areas of management. The operations section was dissatisfied with the money made available to it by the financial section; the latter was concerned about providing more financial support for operations when there seemed to be no adequate return and indeed the railroad was not performing as well as other railroads which were spending a good deal less. Its pricing and marketing functions were not necessarily tied to the operation capability nor the financial needs.

MERGER—AND THE ROAD TO RUIN

Financial stringency and regulatory practices combined with management's unswerving conviction that important benefits would develop early to produce the ill-fated merger. Because of merger associated losses in cash and productivity, however, the merger actually advanced the day of reckoning.

(31) Merger planning

Pennsylvania and New York Central managements established a team for the purpose of planning the merger. While a great deal of effort was expended, pre-merger planning turned out to be largely a paper effort. Plans were produced but little was accomplished toward resolving major interfaces, determin-

ing what was to be done and how, and accommodating differences between the two companies. The ICC was a passive onlooker through it all—no more aware of planning pitfalls than the management or others. Effecting complete consolidation required a number of steps including construction of new facilities to handle rerouting, uniform car control, uniform billing and accounting, and establishing a new organization structure.

(*32*) *Actual consolidation after merger*

At the time of the merger, the Pennsylvania Railroad desperately needed cash. The New York Central was in trouble also. Not surprisingly the two companies found themselves no stronger in union than as independents. Most of the merger startup costs were expended in 1968 and 1969 rather than over a longer period as planned. Service deterioration apparently was accepted as a necessary byproduct of the consolidation process. The faster the consolidation could be accomplished, the faster service could be restored to acceptable levels. Service deteriorated badly with problems such as no billings, multiple billings, misrouting of cars, and even lost trains. Jammed yards, communication failures, angry shippers, and lost business were other manifestations of the effort to consolidate quickly. Management control over the operation dwindled during the organization crisis. To those on the inside it appeared that the merged company's problems were unmanageable. Disputes about marketing philosophy and other problems created a massive turnover of individuals essential to proper running of the railroad. It is important to note that the central region of the Penn Central did not have the same bad service experience or the employee turnover of other parts, suggesting that such problems were not inevitable.

(*33*) *Merger evaluation—The public process*

The Interstate Commerce Commission had before it at one time three merger cases of great significance to the Northeastern part of the country. Even so the Commission refused repeatedly to consolidate the cases and despite all contrary evidence disavowed that it was restructuring the Eastern railroad network. It was committed to a case by case method, thus simplifying its own administrative handling at the expense of providing for the overall public consideration that was so badly needed. The ICC was content to call balls and strikes. In 1966 the ICC recognized that public review of the merger might be necessary and it required periodic reports by the Penn Central partners. Despite all of the information available to the agency about the condition of the railroad, it was not until after the bankruptcy and after congressional outrage developed that the Interstate Commerce Commission instituted any formal review of the Penn Central merger. Another factor of importance was the long delay in the decisionmaking process which was itself a strong influence on management attitudes, e.g. maintaining the 1.3 to 1 stock ratio for a long period directly affected management fiscal policy.

(*34*) *Merger evaluation—The private process*

The chronology of the merger is extensive. Final and serious negotiations date from September 1959. The companies reached agreement in 1962 and filed application with the ICC the following August. In April 1966 merger was approved by the Commission, and finally on January 15, 1968, the Supreme Court had completed consideration of litigation. With unseemly haste the new company died on June 21, 1970. The long delay put a great stress on both companies. While operating separately they had to continually assess the probability and effects of union. They had to keep their stock ratio equivalent at 1.3 contributing to the Pennsylvania decision to maximize earnings. There were very definite fiscal policy implications of the merger such as disposal of Norfolk & Western stock and the urgent need for high payoff which contributed to the decision to diversify. In addition, there were the merger conditions which brought in the New Haven and resulted in expensive labor protection. There is no completely reliable answer here to the question of scale economies. But this merger very definitely makes clear that mergers are no panacea for deeply rooted ills.

(35) Merger evaluation—Monetary impact

The monetary impact of the merger on a short run cost basis was very unfavorable. Anticipated annual savings were $81.2 million. A capital budget of $75 million was allocated for four years. It was exceeded in the first two years when $92.2 million was spent. Total cash outlays were $250.1 million, net cash outlays were $176.2 million. Thus the merger cost considerably more than it was worth in these first years.

THE EVIDENCE AND ANALYSIS

Environmental Conditions

The Penn Central (PC) is not an island unto itself. Like other business enterprises it is caught in the shifting currents of economic and technological change. Being basically a railroad, however, with an enormous fixed investment in immobile assets, the PC, as is true of all railroads, is less free, at least in the short-run, to adapt to changes in the environment in which it carries out its activities. In reviewing the experience of the PC in recent years it is important, therefore, to identify what sorts of external change affected the PC, to measure their impact on the company, and to determine what steps were taken by management—or might have been taken—to adjust to altered circumstances.

An examination of recent trends in the national economy, in transportation generally, and in rail transportation in particular, shows that the PC, in significant degree because of the region in which it operates, has been hampered by a number of forces that are substantially beyond its control. Some of these relate to changes in the production and use of coal (which historically has been the PC's principal source of traffic and revenue), the location of industry, new concepts of distribution management that place emphasis on speed and flexibility of shipment as dimensions of total cost, and in the growing attractiveness of other modes of transportation (notably trucks, using the vastly improved highway system that was put in place beginning in the late 1950's). While all these forces took their toll on the PC in terms of traffic and revenue, they do not appear to be of such magnitude as to explain completely the PC's bankruptcy. Clearly changes in the external environment were a factor, but it is in adapting to them—or failing to do so—that one also finds the sources of the company's ultimate financial collapse. To put all this in suitable perspective calls for a look back at developments in the 1960's—in the economy, in transportation, and particularly at rail transportation in the Eastern region.

TRANSPORTATION AND THE NATIONAL ECONOMY—CHANGING PERSPECTIVES

During the 1960's the role of transportation in the American economy deteriorated somewhat, reflecting less emphasis on goods production. Transportation obviously is concerned with the movement of physical things—minerals, agricultural products, and manufactured goods—which for many years were at the core of domestic economic activity. Recently, however, this has begun to change. It is the services, finance, trade, and government sectors that now are growing most rapidly. In terms of the share of the GNP they represent, agriculture, mining, and non-durable goods have begun to diminish. Even durable goods today account for no more of the GNP than they did a decade ago. By contrast, the services, finance, and trade categories have expanded considerably. The important thing from the transport standpoint is that these sectors generate relatively little demand for freight transportation.

SHARE OF NATIONAL INCOME ACCOUNTED FOR BY MAJOR SECTORS, 1950, 1960, 1970

[In percent]

Sector	1950	1960	1970
Agriculture, forestry, fisheries	7.4	4.1	3.1
Mining	2.1	1.3	.9
Contract construction	5.1	5.4	5.3
Manufacturing	31.0	29.1	27.4
Transportation	5.5	4.3	3.7
Communication and electric, gas, sanitary services	3.0	4.0	3.9
Wholesale and retail trade	18.1	16.5	15.3
Finance, insurance, real estate	8.5	10.1	10.9
Services	9.2	12.0	13.0
Government, Government enterprise	9.8	12.6	15.9
Rest of world	.2	.5	.6

Source: Department of Commerce, Survey of Current Business.

Environmental and related social considerations have also had an effect on transportation. Coal has lost favor as a source of energy for producing electricity. This has hurt the railroads as a group, but the impact has been the most severe in the restrictions on use of higher sulphur content coal. Significantly most of the coalfields served by the Penn Central are high in sulphur content. The net effect of the changes has been to reduce the relative volume of rail transportation and, as a result, to diminish the significance of rail transportation in the economy.

In view of these trends it is not surprising to find that freight transport indices have been shrinking relative to aggregate economic expansion. Between 1960 and 1969 total intercity freight ton-miles rose 43 per cent, but the GNP (in real terms) expanded by 49 per cent. Similarly, intercity freight revenue (in current dollars) increased by only about three-fourths as much as the GNP, resulting in more than a 12 per cent decline in both its share of GNP and National Income.

These shifts in the composition of the economy have been accompanied by changes in technology and other areas that have also had a constraining effect on transportation. The increased use of light weight materials, for example, has reduced the physical demand for transportation. There has been a trend to diversification in the location of factories and other production facilities, bringing them closer to consuming markets and thus also reducing the demand for transportation. Coal, once burned almost entirely at electric generating stations located in the using market after being hauled by rail from the mine, is now consumed in large quantities for electric generation at the mine-head (see discussion of *Coal* below).

INTERCITY FREIGHT TRANSPORTATION AND THE NATIONAL ECONOMY, SELECTED MEASURES, 1960 AND 1969

	1960	1969	Percent change
Intercity freight ton-miles (billions)	1,326	1,901	43.4
Gross national product (billions of 1958 dollars)	$487.7	$724.7	48.6
Intercity freight revenue (millions of current dollars)	$28,760	$46,294	61.0
Gross national product (billions of current dollars)	$503.7	$929.1	84.5
National income (billions of current dollars)	$414.5	$763.7	84.2
Intercity freight revenue as a percent of $100 of GNP	5.710	4.983	−12.7
Intercity freight revenue as a percent of $100 of national income	6.938	6.062	−12.6

Source: Transportation Association of America and Economic Report of the President.

The cyclical pattern of the economy also has a pronounced impact on transportation and especially on the railroads. Rail freight traffic closely parallels the ups and downs of the economy, something that during the 1960's had acute significance for all the railroads and particularly for the Penn Central in the decade's last years.

During the period 1960 through 1969 the economy gyrated dramatically, from rapid expansion to actual contraction. For the decade as a whole the GNP (in real terms) increased at an annual average rate of 4 per cent, but recessions took place at the beginning of the decade (1960–61) and from 1968 (when the Penn Central merger was consummated), until 1970 (when the PC petitioned for bankruptcy), the economy was in almost a continuous state of de-

cline, as is shown in the table. Between the first and second quarters of 1968 economic expansion slowed considerably, with only modest gains recorded through the remainder of the year. In 1969 growth slowed even more, with outright recession setting in during the fourth quarter and persisting through 1970.

Quarterly change in GNP, 1968–70 (percent change of 1958 dollars)

1968:		1970:	
I–II	1.7	IV–I	−1.3
II–III	1.0	I–II	.3
III–IV	.7	II–III	.3
1969:		III–IV	−1.0
IV–I	.6		
I–II	.6		
II–III	.7		
III–IV	−.2		

Powerful though their impact has been on transportation, the diverse forces of change have not uniformly affected the various forms of transportation. Some (pipelines are an example) have increased their significance in the last ten years, some have about held fast (for-hire and private motor carriers), but others, notably the railroads, have lost ground—lost ground, it deserves to be reemphasized, in a sector of the economy that is itself of slightly diminishing importance. The key is that the rail share of intercity freight traffic has been substantially reduced, to the benefit of the other modes—truck (with its greatest penetration coming in general commodities), barge, and pipeline (with the latter two delivering substantial amounts of bulk traffic.)

Although rail traffic losses slowed in the last ten years, the industry's share of traffic and of freight revenue continued to shrink in the 1960's. In 1960 the railroads accounted for 44 per cent of the nation's intercity freight transportation, but by 1969 this had fallen to 41 per cent. Meanwhile their share of freight revenue declined even more, from 28 per cent to 22 per cent. It should be noted, however, that there was a 36 per cent increase in intercity ton-miles from 1960–1969, slightly less than an average annual increase of 4 percent for railroads. This compares with a 44.7 percent increase for all modes of transportation, almost a 5 percent average annual increase. The significant factor is the relative rates of growth of the railroads when compared to the total for all modes of transportation. By contrast, the trucks (specifically the Class I motor carriers) sharply increased their revenues. Their tonnages doubled from 1960 through 1969, their revenues were up even more, and their profits rose by a still greater amount. This is mirrored in the East as well. In a decade when the railroads of the district were experiencing modest growth in traffic tonnage, the Class I motor carriers were doubling their traffic, with revenue up 2.4 times from the 1957–59 base. A major reason for the relatively far superior performance of the trucking industry is its virtual takeover of the small shipment market (a service that was abdicated by the railroads), coupled with the failure of the railroads, until fairly recently, to aggressively market their wholesale service for TOFC—trailer on flat car—and consolidated shipments.

INTERCITY FREIGHT BY MODES [1]

[In Billions of ton-miles]

	Rail		Truck		Oil pipeline		Great Lakes		Rivers and canals		Air		Total
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	
1939	339	62.3	53	9.7	56	10.3	76	14.0	20	3.7	0.01	0	544
1940	379	61.3	62	10.0	59	9.5	96	15.5	22	3.6	.02	0	618
1941	482	62.4	81	10.5	68	8.8	114	14.8	27	3.5	.02	0	772
1942	645	69.5	60	6.5	75	8.1	122	13.1	26	2.8	.04	0	928
1943	735	71.3	57	5.5	98	9.5	115	11.2	26	2.5	.05	0	1,031
1944	747	68.7	58	5.3	133	12.2	119	10.9	31	2.8	.07	.01	1,088
1945	691	67.2	67	6.5	127	12.4	113	11.0	30	2.9	.09	.01	1,028
1946	602	66.6	82	9.1	96	10.6	96	10.6	28	3.1	.08	.01	904
1947	665	65.3	102	10.0	105	10.3	112	11.0	35	3.4	.11	.01	1,019
1948	647	61.9	116	11.1	120	11.5	119	11.4	43	4.1	.15	.01	1,045
1949	535	58.3	127	13.8	115	12.5	98	10.7	42	4.6	.20	.02	917
1950	597	56.2	173	16.3	129	12.1	112	10.5	52	4.9	.30	.03	1,063
1951	655	55.6	188	16.0	152	12.9	120	10.2	62	5.3	.34	.03	1,177
1952	623	54.4	195	17.0	158	13.8	105	9.2	64	5.6	.34	.03	1,145
1953	614	51.0	217	18.0	170	14.1	127	10.6	75	6.2	.37	.03	1,203
1954	557	49.6	213	19.0	179	15.9	91	8.1	83	7.4	.38	.03	1,123
1955	631	49.5	223	17.5	203	15.9	119	9.3	98	7.7	.49	.04	1,274
1956	656	48.4	249	18.4	230	17.0	111	8.2	109	8.0	.58	.04	1,356
1957	626	46.9	254	19.0	223	16.7	117	8.8	115	8.6	.68	.05	1,336
1958	559	46.0	256	21.1	211	17.4	80	6.6	109	9.0	.70	.05	1,216
1959	582	45.3	279	21.7	227	17.7	80	6.2	117	9.1	.80	.06	1,286
1960	579	44.1	285	21.8	229	17.4	99	7.5	121	9.2	.89	.07	1,314
1961	570	43.5	296	22.7	233	17.8	87	6.6	123	9.4	1.01	.08	1,310
1962	600	43.8	309	22.5	238	17.3	90	6.6	133	9.7	1.30	.09	1,371
1963	629	43.3	336	23.1	253	17.4	95	6.5	139	9.6	1.30	.09	1,453
1964	666	43.2	356	23.1	269	17.4	106	6.9	144	9.3	1.50	.10	1,543
1965	709	43.3	359	21.9	306	18.7	110	6.7	152	9.3	1.91	.12	1,638
1966	751	43.0	381	21.8	333	19.1	116	6.6	164	9.4	2.25	.13	1,747
1967	731	41.4	389	22.0	361	20.5	107	6.1	174	9.9	2.59	.15	1,765
1968	757	41.2	396	21.5	391	21.3	112	6.1	179	9.7	2.90	.16	1,838
1969	780	41.0	404	21.3	411	21.6	115	6.0	188	9.9	3.20	.17	1,901
1970 (preliminary)	773	40.1	412	21.4	431	22.4	116	6.0	190	9.9	3.40	.18	1,925

[1] Includes both for-hire and private carriers.

Source: Transportation Association of America.

FREIGHT TRAFFIC AND REVENUE, UNITED STATES AND EASTERN DISTRICT, CLASS I RAILROADS AND CLASS I MOTOR CARRIERS, 1960–69

[1957–59=100]

Year	United States		Eastern district	
	Class I railroads	Class I motor carriers	Class I railroads	Class I motor carriers
Tonnage:				
1960	97.3	112.5	94.1	111.1
1961	93.5	117.8	88.0	113.4
1962	96.9	130.9	91.8	125.1
1963	100.6	137.8	95.2	132.9
1964	106.1	149.2	100.6	149.2
1965	107.7	170.8	102.0	170.2
1966	111.9	188.7	103.3	184.9
1967	108.8	191.2	99.8	188.8
1968	109.8	213.2	98.7	213.7
1969	112.5	228.7	98.7	224.6
Revenue:				
1960	95.1	115.3	92.5	115.3
1961	91.7	120.5	86.4	117.8
1962	94.7	133.4	89.9	130.5
1963	96.5	140.4	91.4	137.1
1964	100.2	153.5	95.1	149.4
1965	104.7	174.6	99.6	167.5
1966	110.0	193.2	101.8	180.3
1967	108.2	197.7	99.8	182.6
1968	115.6	231.6	105.4	219.8
1969	122.6	257.8	109.1	244.3

Source: AAR and ICC.

EASTERN REGIONAL PERSPECTIVE

With its 20,117 miles of line, the Penn Central is the largest railroad in the East and thus is powerfully affected by any change in the relative stature or composition of the region vis-a-vis the nation as a whole. For comparison purposes the primary PC territory can be defined as consisting of the following states:

Connecticut	Pennsylvania	Indiana
Rhode Island	New Jersey	Illinois
Massachusetts	Ohio	Michigan
New York	West Virginia	

Relating trends in this 11-state area to those for the country uncovers several significant deviations, almost all of which have worked to the PC's disadvantage. In very broad outline, the PC territory has lost ground relative to the rest of the nation. Consider population as one index. In 1950, 44 per cent of the U.S. population resided in the 11-state PC area; by 1969 this was down to 42 percent, not a dramatic decline, but nonetheless a measurable and indicative sign. From an economic standpoint the PC area was also losing ground. In 1950 the 11 states accounted for slightly over half of the nation's personal income; by 1969 this share fell below 46 percent, reflecting the fact that in the intervening 20 years personal income for the country had increased 230 percent compared with only 200 percent for the PC area. There occurred an even more pronounced relative decline in manufacturing. In 1950, 65 percent of the nation's total value added by manufacturing took place in the 11 states, but by 1969 this had declined to 54 percent.

In absolute terms, of course, states making up the PC area continued to bulk large in the national economy, but their relative rate of expansion lagged behind most other areas. The explanation lies partly in a shift of industrial facilities to other regions, but part of the answer also is to be found in changes in the technological make-up of the economy. Steel (of which about 80 percent is produced in the 11-state PC area), for instance, was encountering growing competition from other metals and from other materials whose production is more widely distributed. Output of aluminum, plastics, and other products has risen much more rapidly than steel. For the period 1957–1965, revenues from the production of primary iron and steel increased only 1.9 percent, while primary non-ferrous metal manufacturing revenues were up 4.3 percent, plastics and synthetic materials rose 9.0 percent and glass and glass products gained 4.4 percent. To see how all these forces have come together and affected the PC, it is necessary to look at the key traffic sectors—coal, manufactured goods, and smaller shipment movements. Each embodies a different set of underlying

forces and shows the extent to which railroads are affected by external forces, some largely beyond the control of railroad management and some to which an appropriate response could enable a carrier to hold onto or recapture a market.

Coal

Changing patterns of regional output and of commodity use took their heaviest toll on the Penn Central (and on the Eastern roads as a group) in coal. For years coal was the principal source of traffic and of freight revenue for the eastern roads. In 1947, for example, coal constituted about 46 percent of Eastern district tonnage and generated 29 percent of the rail revenue. In the 1950's, however, coal consumption in the United States fell markedly, with the most severe decline in coal production coming in the East. Between 1957 and 1960, coal production in the country declined 16 percent and by 19 percent in the PC region. In the 1960's coal output began to increase, but the gains in the East were less than elsewhere. From 1965 to 1970 coal production rose 16 percent in the United States, but by only 5 percent in the 11 PC states. As a result the PC region's share of the nation's coal production fell from 71 percent in 1957 to 62 percent in 1970, with southern Appalachian states—where the coal is lower in sulphur content and supposedly cheaper to extract—gaining at the expense of states farther north. In 1959 Pennsylvania accounted for about 20 percent of the nation's coal output; by 1970 its share was down to about 15 percent, with Kentucky meanwhile having increased its share from 14 to 20 percent.

In addition to the changing locale of coal production, transformations occurred in the place where coal is burned for the generation of electricity. Since 1965 there has been a three-fold increase in minehead use of coal. This "transportation-by-wire" has deeply cut into rail traffic:

RAIL TRANSPORTATION AND MINEHEAD GENERATION OF COAL

[1957–59=100]

	1960	1965	1966	1967	1968	1969	1970
Transported by rail	92.4	112.9	117.6	123.0	120.5	120.9	124.4
Consumed at minehead	107.7	105.8	157.6	169.3	178.5	226.4	304.3

While changes in the amount, location, and "transportation" of output adversely affected most of the Class I railroads, the effects were most pronounced in the East, with the Penn Central the most severely disadvantaged in recent years.

PERCENT CHANGE IN RAIL TONNAGE OF COAL [1]

	1957–60	1960–63	1965–70
Class I railroads	−19.6	4.2	2.0
Eastern district	−22.6	2.5	−7.8
Penn Central	−18.9	.4	−18.7

[1] In this and similar tables infra, data for the 1960's are reported in 2 yearly groupings because of the ICC's redefinition of commodity groups in 1964. Furthermore, information for individual railroads was not made public by the ICC for 1964.

The 1965 to 1970 picture dramatizes the situation. In those five years, coal tonnage on all Class I carriers registered a modest 2 percent gain but fell by 8 percent on Eastern roads and by 19 percent on the PC (or, prior to merger, on its constituent lines). The PC's share of the Eastern district's coal traffic thus fell from 26 percent in 1965 to 23 percent in 1970. At the same time the Eastern railroads were carrying only 65 percent of all coal hauled by the nation's Class I lines compared to 72 percent in 1965. From a revenue standpoint the picture was less bleak but nonetheless damaging to the PC. The Eastern roads reported a 5 percent increase in revenue from coal traffic between 1965 and 1970, but for the PC coal revenue was off more than 11 percent.

PERCENT CHANGE IN RAIL REVENUE FROM COAL

	1957–60	1960–63	1965–70
Class I railroads	9.8	14.9	20.4
Eastern district	−6.2	11.1	4.8
Penn Central	−6.4	16.0	−11.4

In 1960, the roads which later were to make up the Penn Central were getting approximately 17 per cent of their revenue from coal, but by 1970 that share was down to 15 per cent.

Manufactured Commodity Traffic Generally

The best and most comprehensive insight into the intermodal dimensions of intercity transportation for manufactured goods is provided by the Censuses of Transportation for 1963 and 1967. They present data for the movement of goods in 24 broad shipper categories. Comparing the 1967 statistics with those for 1963 shows that the railroads fared poorly, losing ground across a broad front to the other modes (especially the trucks). In 19 of the 24 product classes, the volume of goods transported (measured in ton-miles) increased. Of these 19 categories, the railroads suffered an absolute ton-mileage decline in 13, while in the other six groups they increased their volume yet still lost position relative to one or more of the other modes. Of the remaining five classes where there were declines in total transport volume, the railroads increased their share in two.

The available published data do not permit a highly refined assessment of trends in the East, but available information shows that the railroad share of the market declined at almost every Eastern city, with the trucks reporting universal gains. At New York City, for example, the railroads accounted for 25.7 per cent of shipment ton-miles in 1963 but only 22.2 per cent in 1967. The trucks meanwhile increased their share from 50 to 73 per cent. Essentially the same is true of the other cities in the PC region.

SHARE OF TRANSPORT MARKET FOR MANUFACTURED GOODS IN SELECTED PRODUCTION AREAS, RAILROADS AND FOR-HIRE MOTOR CARRIERS, 1963 AND 1967

[Percentage of ton-miles]

Production area	1963		1967	
	Rail	Motor carrier [1]	Rail	Motor carrier [1]
Boston	28.7	50.0	17.4	73.4
New York City	25.7	49.2	22.2	59.0
Philadelphia [2]	41.0	42.3	40.2	45.4
Pittsburgh	55.6	23.8	45.2	24.0
Harrisburg	53.8	30.7	48.3	41.3
Allentown/Bethlehem	58.8	34.3	37.7	47.7
Cleveland	56.9	35.3	52.2	39.1
Detroit [2]	73.6	20.4	71.5	23.6
Newark/Jersey City	29.3	44.9	34.6	46.3

[1] Private truck excluded.
[2] Excludes petroleum and coal product movements.

Source: Census of Transportation, 1967.

Two submarkets of manufactured goods—steel and autos—shed useful additional light on what has been happening in rail transportation, particularly in the East.

Iron and Steel Products—Although the iron and steel industry has been losing position relative to the GNP and, indeed, to overall industrial production, it has been a major source of rail revenue. This industry is especially important for Eastern railroads because so much of the nation's steel is produced in this region. Trends of the 1960's reveal that the railroads generally sustained losses in their steel traffic tonnage but were able to offset the revenue consequences with rate increases. Significantly, in retaining its steel traffic and in improving its revenue from it, the PC was considerably more successful than other roads.

PERCENT CHANGE IN RAIL TONNAGE OF STEEL WORKS AND ROLLING MILL PRODUCTS

	1957–60	1960–63	1965–70
Class I railroads	−25.8	0.5	−15.3
Eastern district	−28.4	−1.5	−12.9
Penn Central	−27.2	−2.6	−1.9

As the table shows, steel tonnage moved by the PC was nearly as great in 1970 as in 1965, something which is manifestly not true of all the Class I roads. Paralleling this are the pertinent revenue data, showing a sizable increase for the PC in contrast with far more modest gains for the industry as a whole. In the market for steel transportation, therefore, the evidence indicates that the PC was quite successful in maintaining (and in some respects, improving) its relative position.

PERCENT CHANGE IN RAIL REVENUE FROM STEEL WORKS AND ROLLING MILL PRODUCTS

	1957–60	1960–63	1965–70
Class I railroads	−25.9	−4.0	1.5
Eastern district	−26.8	−8.4	3.9
Penn Central	−15.3	−8.4	28.8

Automoblies—Despite the building of assembly plants and other facilities in other parts of the United States in recent years, the 11 states making up the PC region continue to dominate the nation's auto output, accounting for 56 per cent of assembly units in 1969 or almost exactly the same proportion as in 1957 (and up from the comparable figure earlier in the decade). In terms of intermodal transportation, autos exemplify a major product in which the railroads have succeeded in regaining substantial traffic which had been lost to another mode, namely trucks. In the late 1940's and throughout most of the 1950's, the railroad tonnage of automobiles carried dropped sharply. In 1947, for example, the railroads moved 11.2 million tons of autos; by 1959 this was down to only 4.4 million tons. In the early 1960's, however, the railroads began to fight back with equipment (rack car), service (unit train), and other innovations. The success of this effort is shown in the sharp increases recorded by the railroads between 1960 and 1963. For the Class I roads, tonnage rose by 164 per cent and revenue, reflecting lower rates, increased by 93 per cent.

PERCENT CHANGE IN RAIL TONNAGE OF MOTOR VEHICLES

	1957–60	1960–63	1965–69
Class I railroads	−0.6	163.6	−6.5
Eastern district	−12.2	184.0	−6.4
Penn Central	1.6	158.8	−12.8

As can also be seen, the Eastern roads did even better than the industry. For the PC, however, the situation, though not unfavorable, was less buoyant. Its auto traffic revenue (or the consolidated revenue of the lines later to make up the PC) was up 27 per cent (1965–69) compared with increases of 41 per cent for all Eastern district roads and 44 per cent for the Class I industry.

PERCENT CHANGE IN RAIL REVENUE FROM MOTOR VEHICLES

	1957–60	1960–63	1965–69
Class I railroads	15.3	92.9	44.0
Eastern district	17.1	107.5	40.6
Penn Central	31.8	66.2	26.7

One implication in this resurgence in auto traffic is that the rail mode is potentially capable of highly effective competition in higher-valued manufactured goods traffic and has demonstrated its capacity to constructively respond.

Small Shipment Traffic—Beginning in the late 1940's and early 1950's the railroads vitrually abandoned their LCL (less than carload lot) traffic and today only an inconsequential volume of LCL shipments is handled by railroads. Regardless of the reasons and their persuasiveness, the effect has been to divert to over-the-highway carriers a large and rapidly growing volume of shipments in approximately the 50-pound to 10,000-pound category. Shipments in this size range account for more than 95 per cent of all shipments by general commodity for-hire truckers and in 1970 they represented about 79 million tons of freight. That reflects about a doubling over the last ten years. This traffic, sizable and growing in amount, consists primarily of more highly valued manufactured goods, where service factors (speed, reliability of delivery, etc.) are important. Furthermore, because rates are high, yields (revenue per ton-mile) are significant. The loss of this traffic by the railroad explains their loss of market share at key cities, as shown in the Census of Transportation for 1963 and 1967, and is such an important factor in the deteriorating financial situation of such roads as the PC. With coal traffic down sharply and with the loss of substantial manufactured goods traffic to trucks, the PC (and it is not alone in this respect) has been caught in pincers.

Slowly the railroads are getting back into the smaller shipment sector, albeit indirectly, in the form of TOFC, freight forwarder, and shipper association traffic. In each case the railroad is serving in effect as a wholesaler, moving truck-size or car-size lots that have been assembled by someone else. Based on recent experience the prospects for making gains are encouraging. TOFC carloadings as a share of total rail carloadings increased from 1.8 per cent in 1960 to 4.7 per cent in 1970 for the Class I lines and from 2.2 per cent to 5.0 per cent in 1970 in the Eastern District. Separately identifiable forwarder and shipper association traffic has also been growing, up over 20 per cent from 1965 through 1969 for the industry (some of this traffic moves TOFC and is reflected in those figures). The return of small shipment traffic to the railroads—indirectly in the form of TOFC or consolidated movements—is moderately encouraging, but the amount of ground that has been lost to the trucks is enormous and the recent rate of growth in TOFC and consolidated traffic is such that without an intensive effort the railroads will fall far short of their potential for participation in such traffic.

Divisions

When goods are transported by rail over the facilities of two or more carriers pursuant to a joint rate, there must be a division of the resulting revenue. The divisions issue assumes its greatest importance in the case of interterritorial shipments—between the roads of the Northeast (Official Territory), the South, the Southwest, and the Far West. In 1969 there were over $4 billion (46% of total line haul freight revenue) in interterritorial revenue to be divided among the various regional groupings of railroads. The sheer scale of the revenue subject to divisions suggests the importance of very small percentage shifts in the allocations.[1]

Divisions cases are essentially private arguments among railroads, but when the arguments cannot be settled privately Section 15(6) of the Interstate Commerce Act provides for Commission resolution. Thereafter the Federal courts have jurisdiction. The Commission has authority to initiate the procedure on its own motion, but has rarely done so.

In all, since passage of Section 15(6) in 1920, the Commission has disposed of nine railroad interterritorial division cases—four before World War II.

Relations between the Official Territory (Northeastern area) and railroads operating in other parts of the country have been the most significant. Division with the south are a notable point of controversy,[2] with the Eastern roads contending that the present formula, established in 1953, for

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[1] See Appendix C tables C–1 and C–2 which present data on the relative significance of North-South and East-West traffic to the carriers operating in these regions. See also tables C–3 and C–4 which present data on the volume and directional flow of Official-Southern and Official-Transcontinental traffic.

[2] See Appendix C, table C–5 for legal history of Official-Southern and Official-Transcontinental cases.

north-south traffic, is seriously out of date, given changes in their respective operating expenses and revenue and earnings requirements. Currently the Eastern roads are allocated 44.478% of the revenue, and Penn Central trustees argue that the division for the Eastern railroads should be adjusted upward to 49.604%. The Penn Central estimates that if all major divisions cases were settled properly it would be entitled to an additional $46.3 million per year. From the Penn Central's perspective, therefore, an increased share of divisions is of considerable short-term economic consequence.

The existing divisions between the Penn Central and Western Railroads were established by agreement in 1966. The divisions between the Official Territory and the South were prescribed by the Commission in 1953 on what is called an equal-factor basis—that is each railroad participating in such freight movements receives a portion of the joint rate commensurate with the distance moved. Where freight is moved the same distance in the North and in the South, the Northern railroads and the Southern railroads share the joint rate equally.

The Southern Railroads and the Southern Governors' Conference have resisted efforts by Penn Central and other Northern railroads to obtain a greater share of North-South freight revenues on the ground that such a division would place the south at a competitive disadvantage with the North and hamper economic development in that region. The Southern Governors' Conference particularly has been vigorous in this opposition, contending that it would reestablish what it describes as the same territorial discrimination which existed prior to the Interstate Commerce Commission Docket No. 28300 Class Rate Proceeding, in which rates were placed on a uniform basis throughout the eastern part of the United States. The Conference has insisted in these proceedings that the problems of the Northern railroads, and particularly Penn Central, relate to their own waste and inefficiency and that the south should not be compelled to subsidize waste and inefficiency.

No more complex issues exist than those presented by interterritorial divisions cases. A division's dispute can easily span a dozen years and the outcome may significantly shape the future of an entire region. No definitive treatment is presented here and no comment is herein offered on the merits of any dispute. It is sufficient to note that divisions cases affect the entire railroad industry and every section of the country making equitable resolution of disagreements both vitally important and difficult to obtain.

Financial Performance

The recent financial history of the Pennsylvania and the New York Central Railroads is characterized by a series of ups and downs, but with generally favorable trends in the early 1960's as a preface to the later dismal decline and ultimate collapse. This glimpse of hope capped by doom is summarized here, featuring the course of operating revenues, expenses, and net income; income from other sources; and fixed charges and their coverage. It is important in this summary to distinguish carefully between revenues and income from the railroad and from non-rail subsidiaries.

The data series employed generally cover the period 1958–70 in order to fix the threshold that launched the companies into the 1960's. For the most part, primary interest centers in the absolute numbers and in the relationships between the two, although comparisons are also made with other railroads and groups of railroads.

OPERATING REVENUES, EXPENSES, AND INCOME

Operating revenues for both companies were generally unfavorable in the late 1950's, dropping to a period low in 1961 (Chart A–1). After further hesitation in 1961–63, the combined series advanced rather firmly through 1966, fell into a new trough in 1967–68, and climbed out in 1968–69. They were thus generally characterized by modestly increasing revenues during the 1960's. Compared with the upswing in economic activity and in the revenues of other railroads, their improvement was quite modest. Combined revenues increased by 10 percent (9 for Central and 11 for PRR) from 1961 to 1966 and an additional 7 percent by 1970, or 18 percent overall. This record even fell behind the performance for the Eastern District, with period advances of 14 and 8 per cent, or 23 per cent total, indicating the significantly better record of other area companies (Chart A–2). In the same time periods, Class I railroad revenues advanced by 16 percent and then 12 percent, or 30 percent overall. Industrial production increased by 53 per cent during this period.

Freight revenues increased more favorably than passenger revenues, with a growth in the combined series of 20 percent from the 1958–60 base. The PRR advance was stronger, however, amounting to 10 percent against 5 percent for the Central (Table A–1). The combined growth lagged behind that achieved by the comparison roads (Chart A–3). Rising freight revenues over the decade were supported by varying combinations of favorable changes in traffic volumes, haul patterns, and freight rates (Table A–1). A turning point for these characteristics also appears in 1966. Volume expressed in both tons and ton miles increased steadily during the earlier period (Chart A–4). Up to the 1966 turning point, growth compared favorably with the other Eastern roads. Average haul was virtually static to 1964 (Chart A–5) then started an upward movement in which ton miles advanced faster than tonnage increases, further feeding the favorable revenue trend of this period. The revenue advance was slowed, however, by a general decline in average revenue per ton mile that gradually dropped 11 percent from its late 1960 high, to a low in 1966 (Chart A–6). The first period was thus characterized by favorable revenue trends supported entirely by volume increases in the face of relatively stable haul patterns and declining charges. The same movements characterized the comparison roads (Charts A–4, 5 & 6).

The complexion changed markedly after 1966. A rather anemic freight revenue growth was nourished first by a further rise in average haul in 1967 leading to another plateau and then by sharply rising revenue per ton mile from 1967

on. The modest revenue growth was achieved despite a consistent drop in traffic volume as measured in both tons and ton miles, a force which cannot long be countered by compensating trends. The revenue patterns of the two companies performed about the same and were explained by about the same behavior of the controlling variables.

These variables require further examination in connection with management performance considerations, particularly the pricing policy manifested in the rising ton mile revenues. It suffices here to note briefly the comparative movement of these critical variables. Post-1966 revenue growth lagged far behind the performance of other railroads in the East (Chart A–3) because their traffic revived after the 1967 downturn while the Penn Central's continued to fall. By 1970, Penn Central's average revenue per ton mile was about 1.65 cents (Table A–1), compared to the Class I figure of 1.42 cents.

The comparative figures for the merger partners suggest several important propositions which will be further explored. The similarity in the revenue patterns of the two companies is striking, with coinciding advances and downturns. This coincidence provides the ingredients for the hypothesis that any differences in the two companies—in philosophy or policy—were not great enough to basically influence operating revenue trends; both were apparently influenced far more by other common forces.

It is also desirable to place revenue trends in perspective with respect to the mounting financial problems. The generally upward movement during the 1960's suggests that the company was not done in by a revenue collapse in absolute terms, although higher revenues would, of course, have provided additional strength for withstanding the many onslaughts which finally brought the company down. The 1967–68 revenue trough was indeed rather costly and may be crudely estimated at about $150 million. This is based on straight-line revenue interpolations to replace the depressed 1966 and 1967 figures and an operating ratio of 0.79 achieved before the damaging breaks in the relevant series experienced in 1967. While imposing, this figure is hardly critical.

Comparisons of operating expenses (Table A–2, Chart A–7) must be carefully made to avoid false impressions arising from the fact that higher traffic levels are generally associated with higher costs. There are, however, several points to be noted regarding these series. Both companies were able to keep operating expenses under close control before the merger. However, the patterns are sufficiently different to warrant noting, particularly in connection with a subsequent discussion of maintenance expenditures. PRR operating expenses dropped about 15 per cent in 1957–58 and then stayed around $700 million. Central's expenditures declined more gradually, dropping from $577 million in 1959 to $518 million in 1963, and settling down at about $520–$530 million. In combination, the expenditures declined during 1959–61 and then leveled off through 1967 (Table A–2).

Declining operating expenses with increasing output and rising prices is an interesting anomaly that is readily explained at least in part by restrictions on maintenance expenditures. During the 1958–67 period, PRR maintenance outlays fell from a high of $262.6 million in 1959 to a low of $236.0 million in 1965, a decrease of about 10 percent. By 1967, however, these expenditures were back up to $243.5 million—still 6 percent lower than the high for the period. Meanwhile, the Central's figure fell by approximately 12 percent, declining from a high of $202.9 million in 1959 to a low of $177.5 million in 1967 (Table A–3). These differentials are clearly a mixture of cutting down on maintenance, cost reduction programs, and questionable accounting practices. The management performance and fiscal policy analyses will undertake to unravel this mixture.

In 1968, operating expenditures increased by about $35 million, but this was followed by increases of over $145 million in each of the next two years. The extra $400 million of operating expenses laid out in 1969 and 1970 at an operating ratio of 0.79 (the approximate 1966–1967 operating ratio*) was

*The actual revenues multiplied by the operating ratio of 0.79 yields the operating expenses based on pre-merger operating performance. The difference between actual operating expenses and the operating expenses derived in this fashion approximates $400 million, the "extra" operating expenses for 1968 through 1970.

enough in itself to wipe out any hope of net income. Even the one-year increments of about $145 million were much larger than net railway operating income in any year after 1956. In these terms, rising costs were more damaging than softening revenues (Table A–2).

Although uncertainty about the relative weights of cost saving and maintenance scrimping remains, operating expenses are most meaningfully stated with reference to operating revenues. One such expression is the operating ratio (of expenses to revenues) (Table A–2). It is by now fully predictable that the operating ratio for the two companies separately, and as a composite, declined steadily through 1966 and then rose sharply. It is somewhat surprising, particularly in the light of relationships to be considered later, that the PRR enjoyed through the years a somewhat lower ratio than its merger partner, with the differential ranging as high as 3.6 points and averaging 2.14 points over the 1958–67 period. This margin represents $19 million annually expressed in terms of the PRR's average revenue over these years, or a total of nearly $200 million.

The ratios maintained by these companies are expectedly higher than those for the system as a whole and for most other individual companies (Chart A–8). The falling ratios to 1966 followed the national (all Class I) trend, but at a higher rate to reduce the gap. But the national upturn after 1966 was less drastic and less insistent, so the Penn Central soon lost touch completely with other companies' measures. While systemwide forces were pushing operating ratios up during the last half of the 1960's, special influences shot the Penn Central's out of sight later on. With minor exceptions, the Penn Central's operating ratio exceeded the comparison roads' ratios for the entire decade.

NET RAILROAD OPERATING INCOME (NROI)

An important figure in railroad income statements is "net revenue from railway operations", which also reflects the relationship between operating revenues and operating expenses (Table A–2). As the revenue and cost information has signalled, both companies enjoyed encouraging increases in net revenues through 1966, up 41 percent over 1961 in the composite series. The figure dropped off from $335 million in 1966 to $267 million in 1967, eased down to $238 million by 1969, and then crashed to a scant $134 million in 1970. The performance of the two companies was remarkably consistent in terms of this measure, with the PRR generally contributing about 60 percent of the composite revenues. As previously indicated, the catastrophic emasculation of this figure is primarily due to the increase in costs.

Equipment and joint facility rents and taxes are deducted from net revenues to produce "net railway operating income." Since taxes were quite stable during the study period the main interest is in rents—moneys paid for the use of equipment, primarily freight cars, belonging to another railroad or some other lessor. For the combined companies, this figure advanced rather modestly until 1966, and then shot up in large annual increments to a total of $222 million—almost double the 1960 figure (Table A–4). Rentals jumped from 45 percent of net railway operating revenue in 1964 to 61 percent in 1967, 77 percent in 1968 and to over 160 percent in 1970. While a rising trend for all railroads collectively, this percentage is generally under 30.

The roots of this cost behavior are also somewhat ambiguous. Changes can reflect the levels of use and detention of "foreign" cars and the associated rental payments or a change in equipment acquisition policy. Facilities purchased appear in capital accounts, with associated costs reflected in such financing charges as debt interest. If the same facilities are leased, the corresponding cost items reside in the rental account. These companies (and particularly the PRR) turned increasingly to leasing during the 1960's, indicating that a significant portion of the rental increment represents a substitute for financing costs entered under "fixed charges". This is a matter for exploration in a subsequent consideration of fiscal policy. Regardless of the cause, the immediate effect of this swelling account is to further overwhelm the already

flabby revenues and contribute significantly to the deficits in "net railway operating income."

"Net railway operating income" (NROI) is the first "terminal" figure in the income statement, measuring the portion of annual revenues remaining after payment of operating expenses, rents, and taxes. It is a sum available for payments to capital suppliers in the form of interest or dividends. Added to the sum are dividends from other companies and other miscellaneous income. This critical figure dropped off drastically for both companies during the late 1950's, the PRR settling in 1960 and the Central in 1961 (Table A–2). It then rose promisingly for both companies until the 1966 break, dropping steadily and drastically from then on. Because of the rental influence, it dropped more and faster than net revenues, producing deficits which soared from $27 million in 1968 to $68 million in 1969 and an unbelievable $237 million in 1970.

All of the unfavorable movements which have been recounted come home to roost in this telling measure which spiraled downward after 1966. Operating revenues first fell off and then recovered only to be overwhelmed by higher operating expenses which were in turn compounded by the increased rentals. In these summary terms, the 1966–67 break divides the 1960's into two periods composed of increasingly favorable operating results followed by sharp declines leading to certain doom. The changing tide is depicted in the percentage of gross revenue carried through to NROI, starting with 1.2 percent (pro forma) in 1961 and working up to 7.2 percent before falling off to negative values.

AFTER NROI

With debt such an important part of railroad capital structures, contractual interest payments called "fixed charges" constitute an important reduction of net railway operating income before it can be pocketed as "net income." Meanwhile, the NROI is supplemented by "other (non-operating) income" as an additional source of fixed charge coverage and net income.

Both companies took on a relatively heavy burden of fixed charges as a result of rather large postwar investment programs. Both also embarked subsequently on substantial programs of debt reduction so that fixed charges were declining during the early part of the period of perspective (Table A–6). The composite figure declined from over $90 million in 1958 to a low of $75 million in 1964, then rose continuously to $85 million in 1967 and on to a new high of $144 million in 1970. The pattern was essentially the same for each company although the specific contours were quite different, with the Central's figures dropping more and rising less. The Central dropped from $45 million to $35 million and then advanced to only $36 million by 1967, while the PRR slid from $45 million only to $40 million and then recovered to $49 million.

This coincidence of the ballooning of fixed charges, despite the big switch to leasing, with the collapse of NROI presented a particularly lethal combination. But this unfavorable balance was not peculiar to the immediate prebankruptcy period. As a result of the rising NROI and falling fixed charges in the early 1960's, a positive balance was achieved for both companies in 1965 and 1966 (Table A–6). These were the only years, however, in the entire period 1958–70 when the charges were covered by NROI. During the 10 years 1958–67,

the PRR generated about $266 million of NROI and $437 million of fixed charges, while the Central had $230 million and $381 million. The PRR was short about $171 million and the Central approximately $149 million, or a total of $320 million. For the industry as a whole, fixed charges run about 40–50 percent of NROI. A chronic ratio of over 100 percent is certainly a crisis signal. The $320 million provides the dimension of support required from sources other than operating income to keep the companies going.

Over the years, the PRR had higher absolute but lower relative fixed charges than the Central. One indication is the ratio of NROI to fixed charges. In the period 1956–65, the PRR ratio was generally higher but the position changed in the immediate premerger years to a slight Central advantage. The comparative ratios for the PRR and the Central, respectively, were 1.08 and 1.39 for 1965, 1.26 and 1.60 for 1966, and 0.30 and 0.09 for 1967. The differences were certainly not significant and neither company was supported by rail income in the recent past.

The long-time salvation of the companies is found in the income statement item labelled "other income", contributions from sources other than the operation of the primary railroads (Table A–6). Both companies were rather well loaded in this respect. The outside income tends to be more stable than the railroad-generated income and its proportion fluctuates rather widely. Between 1964 and 1970, for example, it ranged for Southern district railroads from 20.2 to 42.4 percent and for Eastern district from 33.5 to 65.9 percent. After 1958, NROI exceeded other income for the two companies and as a composite only in the three years 1964–66. During the 1958–67 period, composite NROI totalled $495.8 million and other income $684.7 million, a discrepancy of $188.9 million.

The two items together—NROI and other income—constitute a pot of funds available to cover fixed charges, with any residual providing "net income" (Table A–6). Because of the strength of the other income, this was a positive sum for all years for the two companies and for all except 1970 for the Penn Central. It exceeded fixed and miscellaneous charges, however, only in 1963–67. For the 13 years 1958–70 the accounts about broke even, with fixed charges aggregating $1.2 billion and income available $1.0 billion. Dropping the 1970 deficit produces a positive balance of about $170 million. Premerger (through 1967), the composite balance was plus $258.6 million, or an average of only about $26 million annually. These figures show that the strength of the other income enabled the companies to realize a net income in 1963–66 and 1958–59. For the 13 years 1958–70, positive net income totalled $281.5 million which was offset by $434.1 million in losses, creating a negative balance of $152.6 million. Other regional carriers fared far better in this respect (Chart A–9).

Over the entire 1958–70 period under review, the railroads generated aggregate positive NROI of only $164.5 million, and incurred fixed charges of $1,180.5 million, running short by over a billion dollars. If the post merger experience is eliminated, the NROI is $495.8 million against fixed charges of $817.4 million, cutting the shortage to $321.6 million. While not quite so frightful, the elimination of postmerger experience still leaves a very bleak picture. Appearances suggest that this story could only end as it did—in utter disaster.

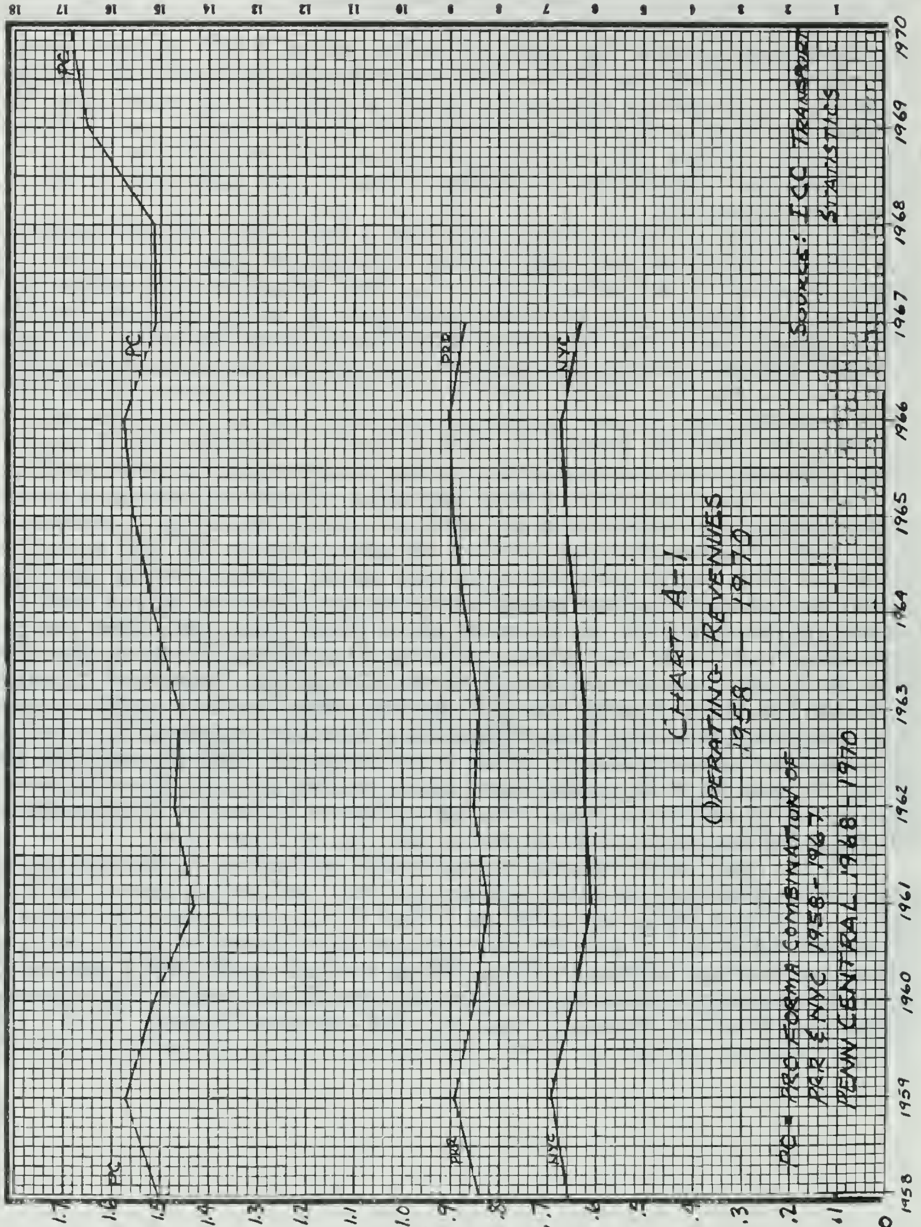
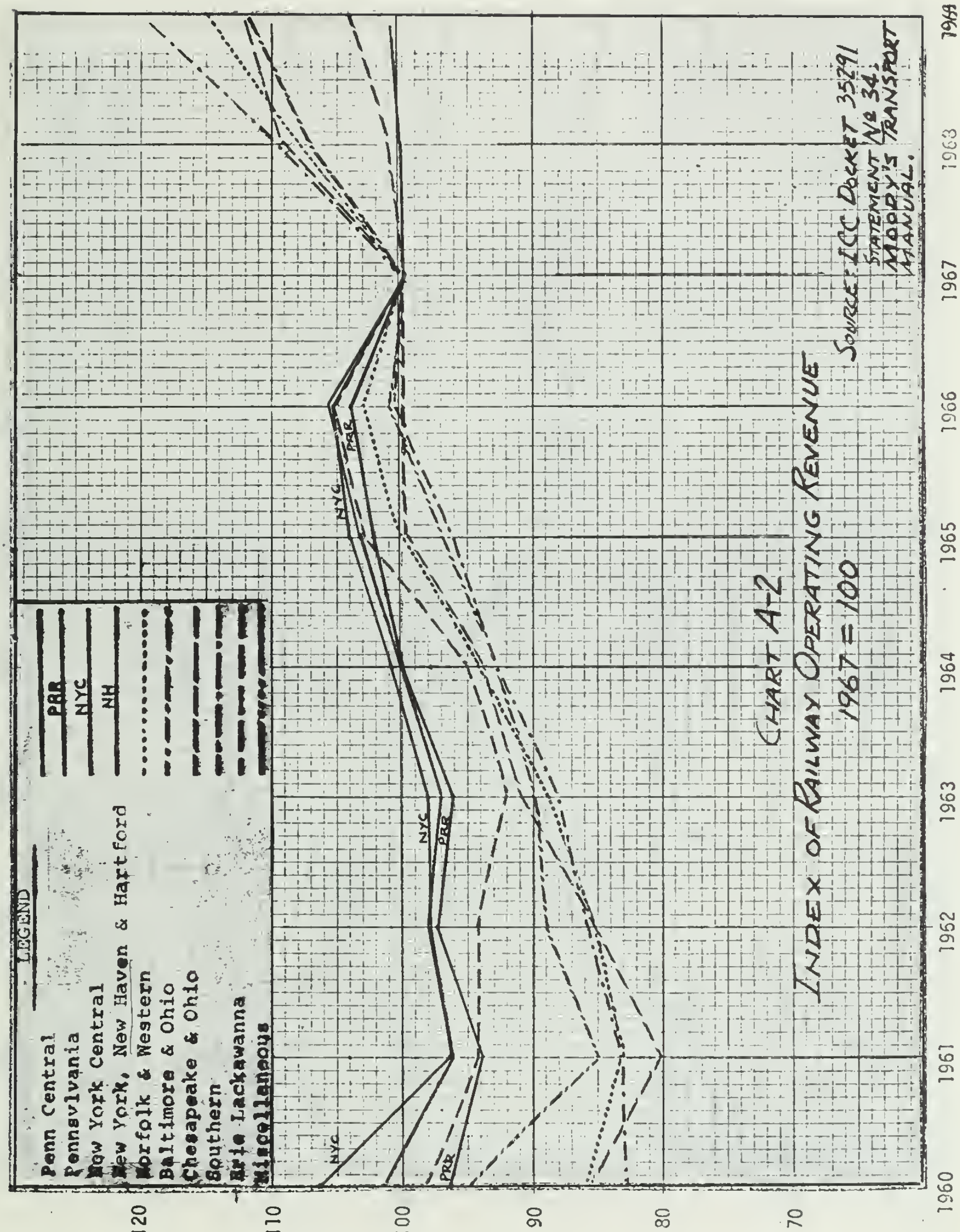
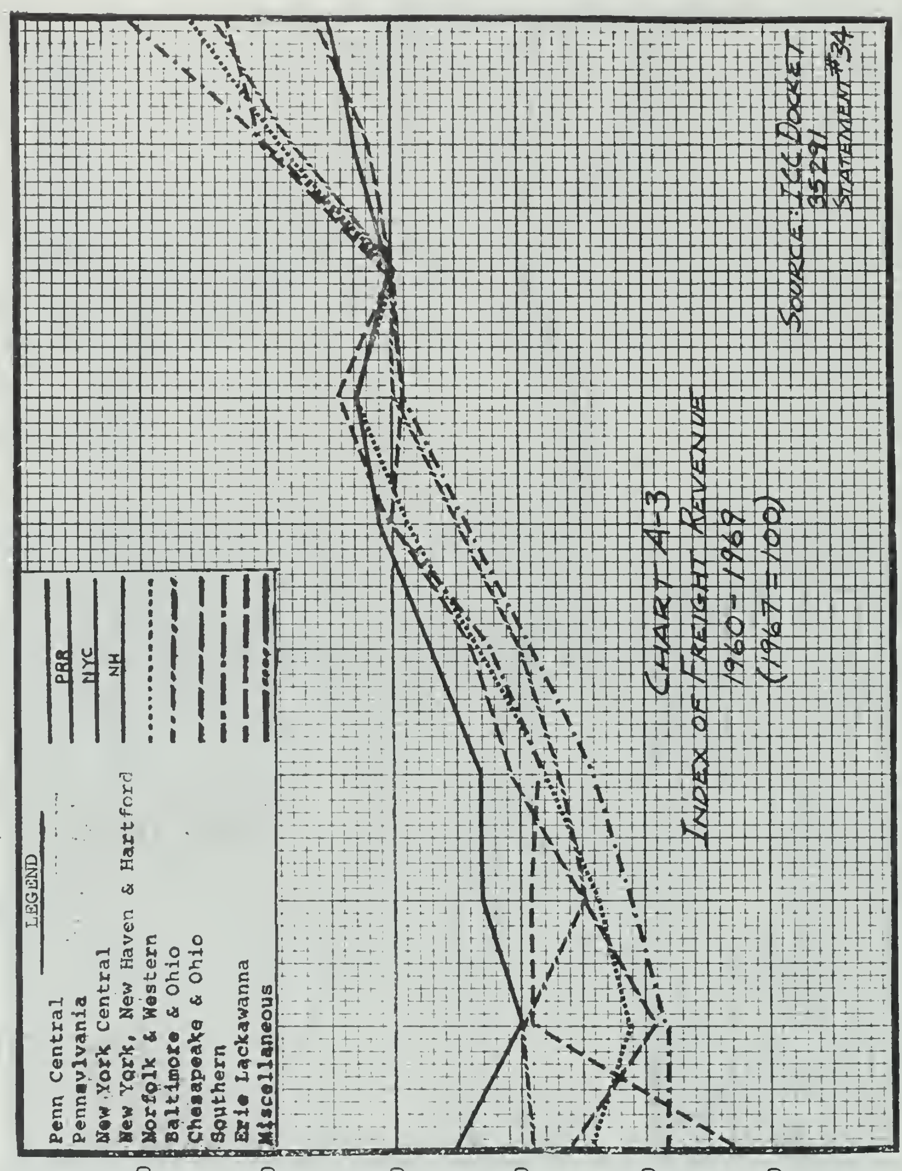
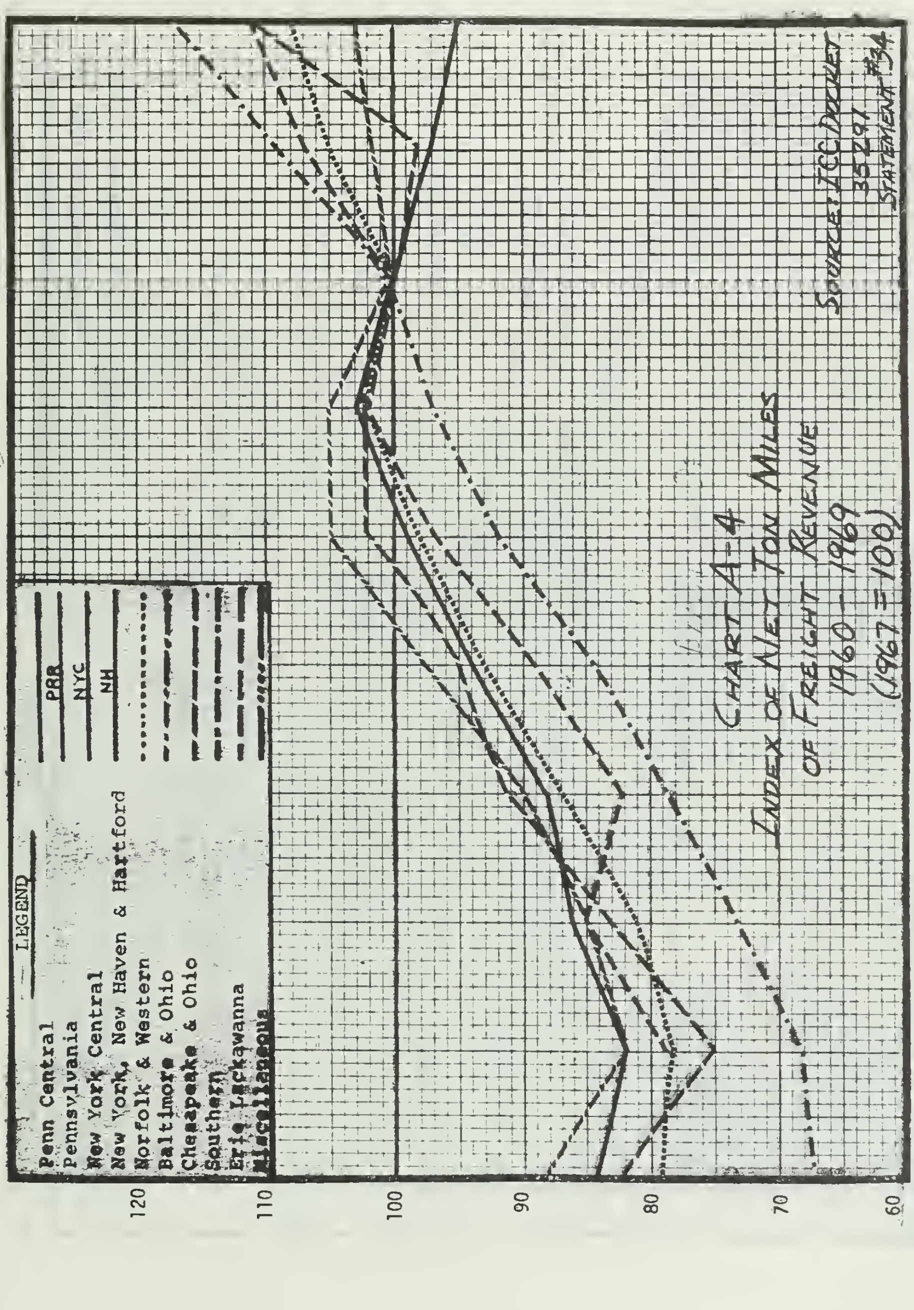


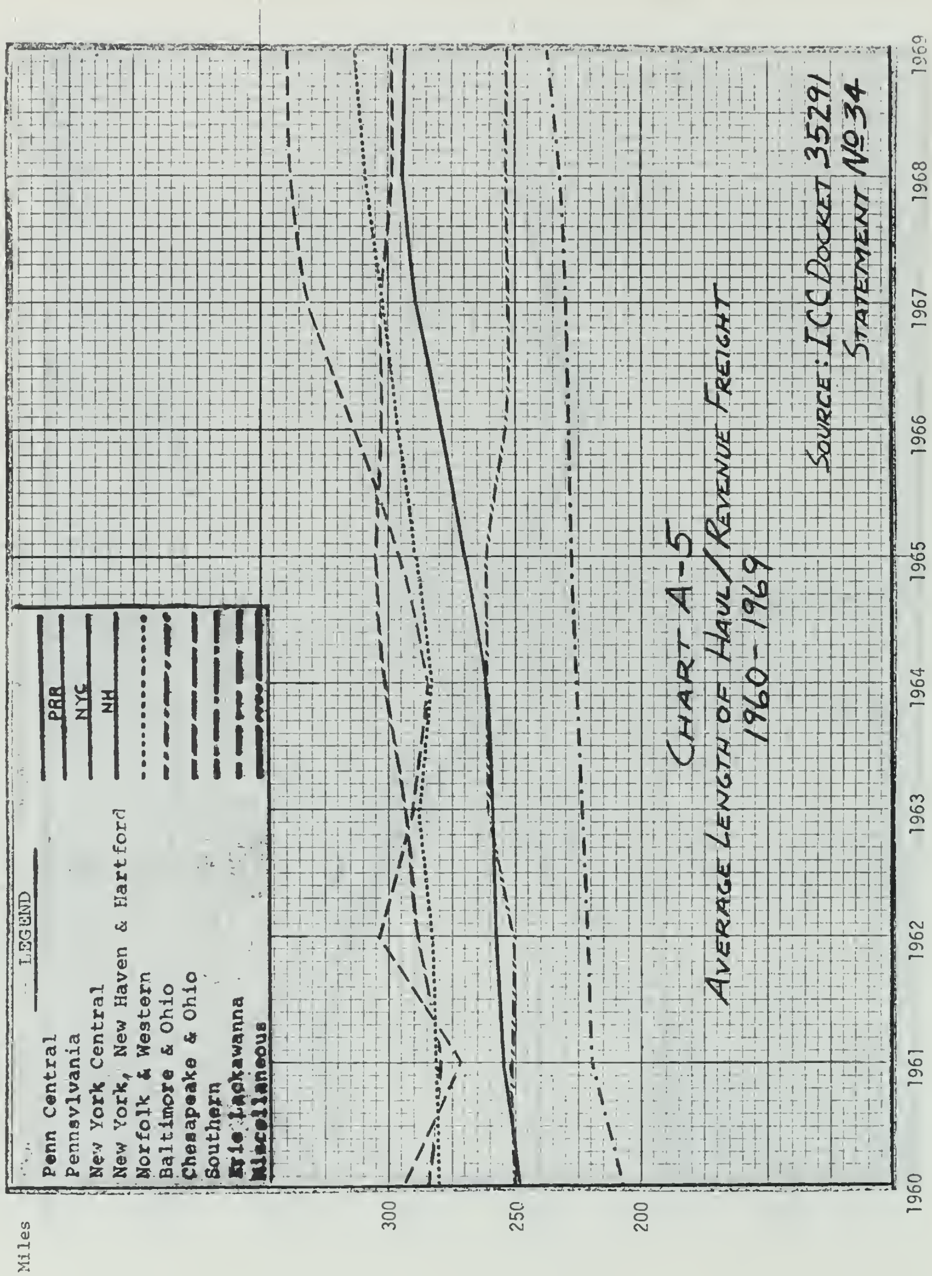
CHART A-1
OPERATING REVENUES
1958 — 1970
PC = PRO FORMA COMBINATION OF
PRR & NYC 1958-1967
PENN CENTRAL 1968-1970
SOURCE: ICC TRANSPORT STATISTICS
BILLIONS
PC
PRR
NYC


LEGEND
Penn Central
Pennsylvania
New York Central
New York, New Haven & Hartford
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
PRR
NYC
NH
120
110
100
90
80
70
1960
1961
1962
1963
1964
1965
1966
1967
CHART A-2
INDEX OF RAILWAY OPERATING REVENUE
1967 = 100
SOURCE: ICC DOCKET 35291
STATEMENT No 34;
MOODY'S TRANSPORT
MANUAL.

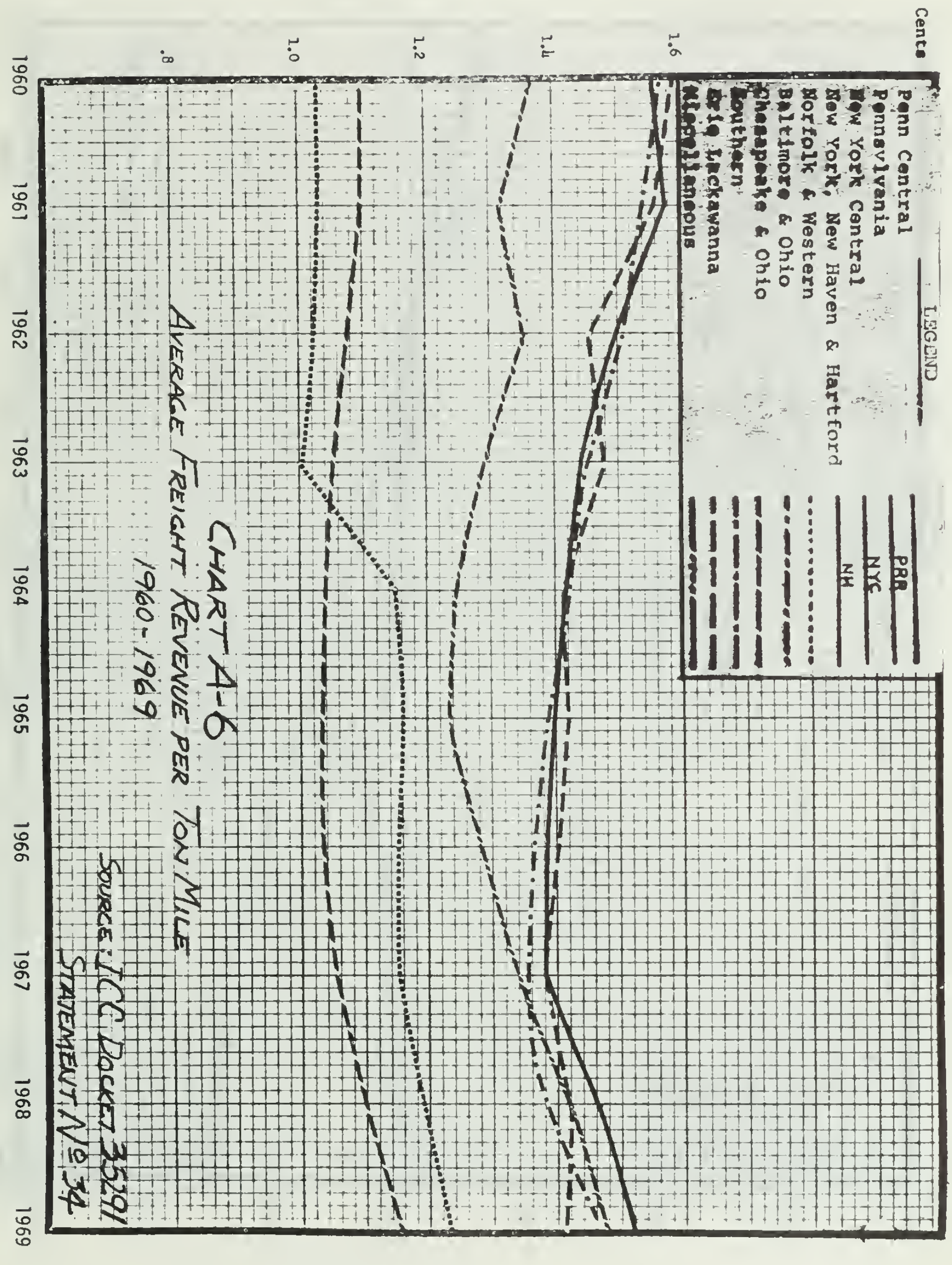


LEGEND
Penn Central
Pennsylvania
PRR
New York Central
NYC
New York, New Haven & Hartford
NH
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
CHART A-3
INDEX OF FREIGHT REVENUE
1960-1969
(1967=100)
SOURCE: I.C.C. DOCKET
35291
STATEMENT #34
120
110
100
90
80
70
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969


LEGEND
Penn Central
Pennsylvania
PRR
New York Central
NYC
New York, New Haven & Hartford
NH
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
CHART A-4
INDEX OF NET TON MILES
OF FREIGHT REVENUE
1960 - 1969
(1967 = 100)
SOURCE: ICC DOCKET
35291
STATEMENT #34
120
110
100
90
80
70
60
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969



LEGEND
Penn Central
Pennsylvania
New York Central
New York, New Haven & Hartford
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
PRR
NYC
NH
CHART A-5
AVERAGE LENGTH OF HAUL/REVENUE FREIGHT
1960-1969
SOURCE: ICC DOCKET 35291
STATEMENT NO 34
Miles
300
250
200
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969


Cents
1.6
1.4
1.2
1.0
.8
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
LEGEND
Penn Central
Pennsylvania PRR
New York Central NYC
New York, New Haven & Hartford NH
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
CHART A-6
AVERAGE FREIGHT REVENUE PER TON MILE
1960-1969
SOURCE: I.C.C. DOCKET 35291
STATEMENT № 34

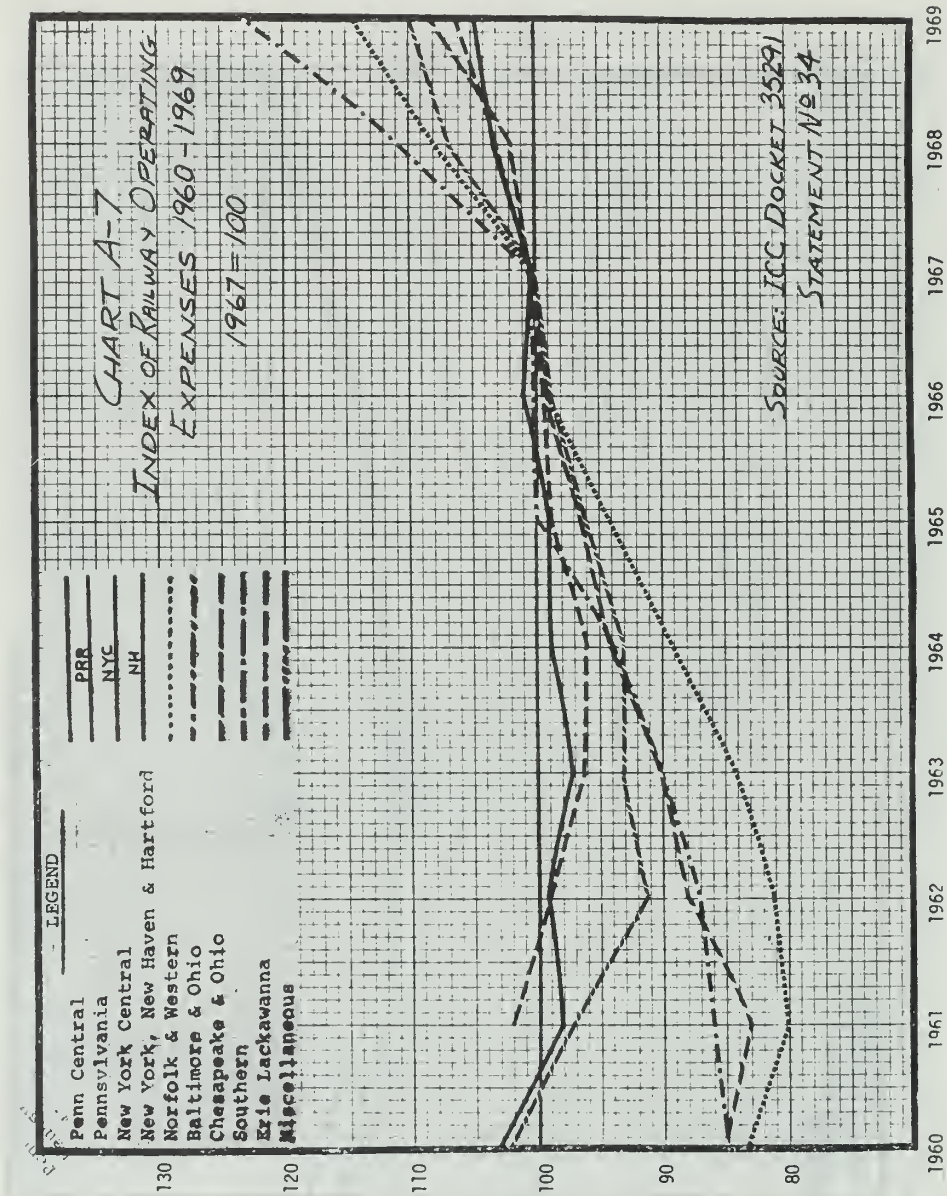


CHART A-7
INDEX OF RAILWAY OPERATING
EXPENSES 1960-1969
1967 = 100
SOURCE: ICC DOCKET 35291
STATEMENT No 34
LEGEND
Penn Central
Pennsylvania PRR
New York Central NYC
New York, New Haven & Hartford NH
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
130
120
110
100
90
80
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

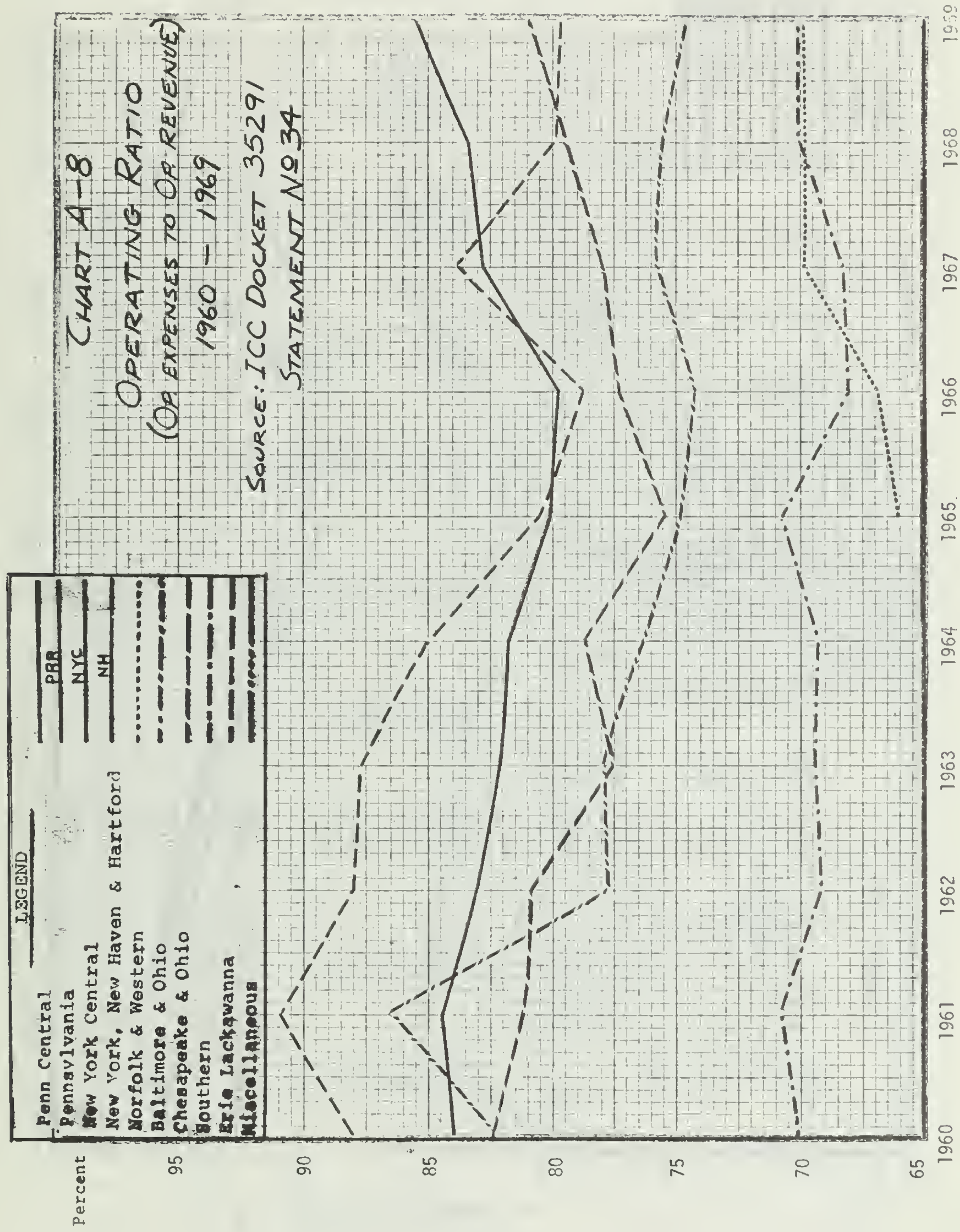


CHART A-8
OPERATING RATIO
(OP EXPENSES TO OP REVENUE)
1960 - 1969
SOURCE: ICC DOCKET 35291
STATEMENT No 34
LEGEND
Penn Central
Pennsylvania PRR
New York Central NYC
New York, New Haven & Hartford NH
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
Percent
95
90
85
80
75
70
65
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

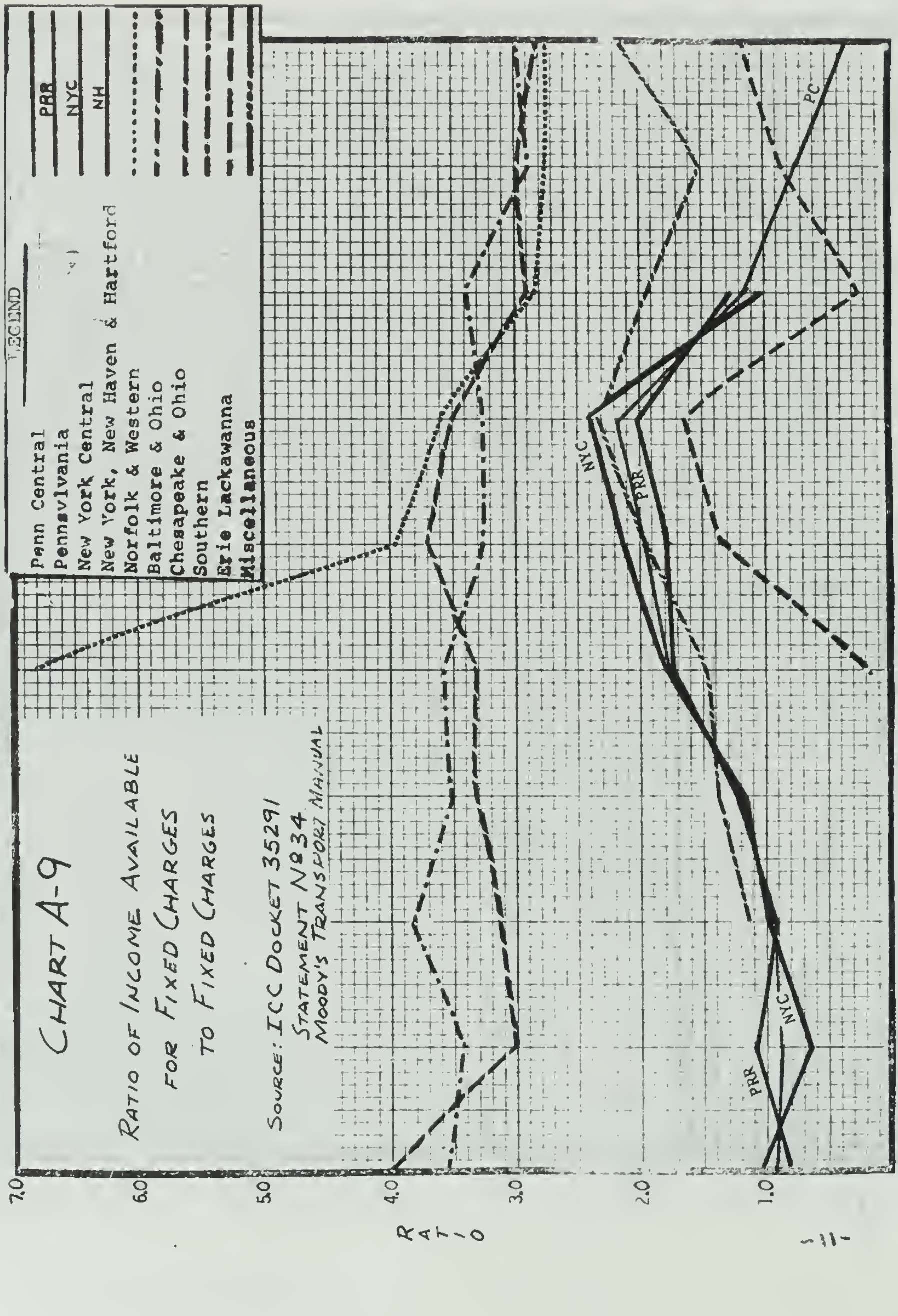


CHART A-9
RATIO OF INCOME AVAILABLE FOR FIXED CHARGES TO FIXED CHARGES
SOURCE: ICC DOCKET 35291 STATEMENT NO 34 MOODY'S TRANSPORT MANUAL
LEGEND
Penn Central
Pennsylvania
New York Central
New York, New Haven & Hartford
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
PRR
NYC
NH
PC
RATIO
7.0
6.0
5.0
4.0
3.0
2.0
1.0
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

-11-

TABLE A-1.—SELECTED RAILROAD PERFORMANCE MEASURES—PENN CENTRAL, PENNSYLVANIA, AND NEW YORK CENTRAL (1958–70)

[1958, 1959, 1960=100][1]

Year	Freight revenue						Revenue-tons carried					
	Penn Central[2]		Pennsylvania		New York Central		Penn Central[2]		Pennsylvania		New York Central	
	Millions	Index	Millions	Index	Millions	Index	Millions	Index	Millions	Index	Millions	Index
970	$1,392.4	119.7					281.7	98.0				
969	1,344.6	115.6					300.0	104.4				
968	1,251.8	107.7					286.1	99.6				
967	1,214.7	104.5	$702.4	107.5	$512.3	101.9	310.8	108.2	175.8	110.2	135.1	100.1
966	1,248.5	107.4	718.9	110.0	529.6	105.4	322.6	112.3	183.1	114.8	139.5	106.7
965	1,221.6	105.1	703.3	107.6	518.2	103.1	319.9	111.3	177.3	111.2	142.6	109.1
964	1,171.3	100.7	676.4	103.5	494.9	98.5	313.5	109.1	173.5	108.8	140.1	107.2
963	1,118.7	96.2	643.9	98.5	474.8	94.5	297.2	103.4	164.3	103.0	132.9	101.7
962	1,124.7	96.7	651.3	99.6	473.3	94.2	290.1	101.0	161.2	101.1	129.0	98.7
961	1,102.5	94.8	616.9	94.4	485.7	96.7	275.8	96.0	152.8	123.0	123.0	94.1
960	1,147.2	98.7	641.1	98.1	506.1	100.7	294.5	102.5	161.2	101.1	133.4	102.1
959	1,193.1	102.6	676.0	103.4	517.0	102.3	295.7	102.9	163.7	102.6	132.0	101.0
958	1,123.8	96.6	638.0	97.6	485.9	96.7	280.5	97.6	154.1	96.6	126.4	96.7

Year	Revenue ton-miles						Average haul per revenue ton (miles)						Average revenue per ton-mile					
	Penn Central[2]		Pennsylvania		New York Central		Penn Central[2]		Pennsylvania		New York Central		Penn Central[2]		Pennsylvania		New York Central	
	Billions	Index	Billions	Index	Billions	Index	Miles	Index	Miles	Index	Miles	Index	Cents	Index	Cents	Index	Cents	Index
970	84.0	113.7					298.0	117.1					1.658	106.1				
969	88.2	117.1					293.9	115.5					1.525	97.6				
968	88.6	117.2					302.5	118.9					1.446	92.5				
967	89.6	121.2	50.7	119.0	38.9	124.2	288.4	113.3	288.6	108.2	288.0	120.1	1.356	86.8	1.385	90.5	1.317	82.0
966	92.1	124.6	53.3	125.1	38.7	123.6	285.5	112.2	291.2	109.2	277.8	115.8	1.356	86.8	1.348	88.0	1.367	85.1
965	89.1	120.6	51.6	121.1	37.3	119.1	278.7	109.5	292.0	109.5	262.0	109.3	1.371	87.7	1.359	88.8	1.387	86.4
964	83.6	113.1	49.8	116.9	33.8	108.0	266.7	104.8	286.9	107.6	241.6	100.7	1.401	89.6	1.359	88.8	1.463	91.1
963	78.8	106.6	46.4	108.9	32.4	103.5	265.2	104.2	282.4	105.9	243.9	101.7	1.420	90.1	1.388	90.7	1.465	91.2
962	76.7	103.8	45.2	106.1	31.5	100.6	264.4	103.9	280.7	105.3	243.9	101.7	1.466	93.8	1.440	94.1	1.505	93.7
961	72.7	98.4	42.1	98.8	30.7	98.1	263.7	103.6	275.3	103.2	249.3	104.0	1.480	94.5	1.466	95.6	1.496	93.2
960	75.1	101.6	42.8	100.5	32.3	103.7	255.0	100.2	265.4	99.5	242.4	101.1	1.528	97.8	1.499	97.9	1.566	97.5
959	75.2	101.7	43.4	101.2	31.8	101.6	254.3	99.9	265.2	99.5	240.9	100.4	1.587	101.5	1.557	101.7	1.626	101.2
958	71.4	96.6	41.5	97.4	29.9	95.9	254.8	100.1	269.2	101.0	236.4	98.6	1.574	100.7	1.538	100.5	1.626	101.2

[1] Average annual amount for 1958–60 used as index bases.
[2] Pro forma, 1958–67.

Source: Association of American Railroads, O.S. series.

TABLE A-2.—SELECTED MEASURES OF FINANCIAL PERFORMANCE—PENN CENTRAL, PENNSYLVANIA RR., AND NEW YORK CENTRAL RR., 1958–70

Year	Operating revenues (millions)			Operating expenses (millions)			Net revenue from railway operations (millions)			Operating ratio of expenses to revenue (per cent)			Net railway operating income (millions)		
	Penn Central[1]	Pennsylvania	New York Central	Penn Central[1]	Pennsylvania	New York Central	Penn Central[1]	Pennsylvania	New York Central	Penn Central[1]	Pennsylvania	New York Central	Penn Central[1]	Pennsylvania	New York Central
70	1,691.0			1,557.0			134.0			92.1			(236.5)		
69	1,652.0			1,414.2			237.8			85.6			(67.8)		
68	1,516.2			1,267.9			248.3			83.6			(27.0)		
67	1,509.8	873.8	636.0	1,233.3	703.0	530.4	266.7	170.8	105.6	81.7	80.5	83.4	17.5	14.4	3.1
66	1,577.9	907.7	670.2	1,243.1	708.6	534.5	334.8	199.1	135.7	78.8	78.1	79.8	113.6	56.5	57.1
65	1,554.0	892.5	661.5	1,227.7	699.7	528.1	326.3	192.8	133.4	79.0	78.4	79.8	96.0	45.5	50.3
64	1,514.0	873.2	641.5	1,221.8	697.7	524.2	293.0	175.5	117.3	80.7	79.9	81.7	73.4	39.2	34.2
63	1,463.4	840.1	623.3	1,194.4	676.8	517.5	269.0	163.3	105.8	81.6	80.6	84.6	50.0	28.8	21.1
62	1,473.2	850.1	622.6	1,215.0	692.5	522.5	258.2	158.2	100.1	82.5	81.5	83.9	30.5	17.9	12.6
61	1,432.1	820.1	612.0	1,195.2	671.8	523.4	236.9	148.3	88.6	83.5	81.9	85.5	17.3	17.8	(.5)
60	1,518.2	843.7	674.5	1,266.3	698.7	567.6	251.9	145.0	106.9	83.4	82.8	84.2	20.4	4.2	16.2
59	1,576.9	887.7	689.2	1,304.3	727.5	576.9	272.6	160.2	112.3	82.7	82.0	83.7	53.8	29.8	24.0
58	1,503.2	844.2	659.0	1,276.4	715.2	561.2	235.9	129.0	97.8	84.9	84.7	85.2	23.6	11.7	11.8

[2] Pro forma, 1958–67.

Source: ICC Transport Statistics, Moody's Transport Manual.

TABLE A-3.—TOTAL MAINTENANCE EXPENDITURES; SELECTED RAILROADS; 1958-70[1]

[In millions of dollars]

	Penn Central[1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	551.2			138.2	139.5	133.6
1969	473.3			126.8	133.4	117.6
1968	427.6			123.5	122.1	102.0
1967	421.0	243.5	177.5	114.0	118.5	86.8
1966	421.8	239.3	182.5	114.3	115.4	87.2
1965	416.1	237.1	179.0	108.2	111.2	87.8
1964	418.4	239.1	179.3	107.2	113.7	87.1
1963	420.9	236.0	184.9	112.4	131.3	80.9
1962	435.2	247.5	187.7	73.6	108.0	79.4
1961	418.5	232.7	185.8	114.8	100.6	78.0
1960	449.0	246.6	202.4	114.5	105.6	75.9
1959	465.5	262.6	202.9	117.0	101.4	77.2
1958	437.2	252.0	185.2	107.6	97.2	81.4

[1] Pro forma combination of Pennsylvania and New York Central; 1958-67.

Source: Moody's Transportation Manual.

TABLE A-4.—EQUIPMENT AND JOINT FACILITIES RENTS,[1] SELECTED RAILROADS, 1958-70

[In millions of dollars]

Year	Penn Central[2]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	221.9			64.0	18.6	20.0
1969	192.7			59.9	12.5	19.2
1968	184.0			61.1	4.7	29.3
1967	161.7	96.9	64.8	58.6	7.7	29.0
1966	141.7	89.7	52.0	53.3	3.8	34.5
1965	143.5	92.5	51.0	47.5	4.1	27.1
1964	132.8	86.0	46.8	47.1	3.7	21.3
1963	129.1	82.0	47.1	41.6	3.6	17.8
1962	126.0	82.0	44.0	43.0	3.7	14.9
1961	114.5	73.3	41.2	39.5	3.6	15.9
1960	115.8	78.8	37.0	30.4	3.7	15.2
1959	103.4	71.2	32.2	24.9	3.6	13.2
1958	99.3	65.2	34.1	24.3	3.2	11.5

[1] Gross outlay for rental of equipment and joint facilities.
[2] Pro forma combination of Pennsylvania and New York Central, 1958-67.

Source: Moody's Transportation Manual.

TABLE A-5.—NET EXPENDITURES FOR FREIGHT CAR LEASING PENN CENTRAL, PENNSYLVANIA, AND NEW YORK CENTRAL, 1958-69

[In millions of dollars]

Year	Penn Central[1]	Pennsylvania	New York Central
1969	32.9		
1968	27.1		
1967	24.6	18.8	5.8
1966	24.0	19.7	4.3
1965	30.6	25.1	5.5
1964	31.0	26.3	4.7
1963	28.4	23.9	4.5
1962	29.7	25.1	4.6
1961	29.6	25.7	3.9
1960	27.8	25.2	2.6
1959	15.3	12.6	2.7
1958	10.6	7.8	2.8

[1] Pro forma combination of Pennsylvania and New York Central; 1958-67.

Source: ICC Form A, Railroad annual reports.

TABLE A-6.—NET INCOME AS A FUNCTION OF NROI, OTHER INCOME, FIXED AND MISCELLANEOUS CHARGES—PENN CENTRAL, PENNSYLVANIA RR., NEW YORK CENTRAL RR. (1958–70)

[Millions of dollars]

Year	Net railway operating income			Other income			Miscellaneous charges			Income available for fixed charges			Fixed charges			Net income		
	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central
1970	(236.5)			66.5			11.4			(181.4)			144.4			(325.7)		
1969	(67.8)			119.0			10.7			40.4			123.3			(82.8)		
1968	(27.0)			129.9			10.2			92.7			95.4			(2.8)		
1967	17.6	14.5	3.1	93.6	56.9	36.7	11.0	8.5	2.5	100.1	62.9	37.2	84.8	48.8	36.0	15.3	14.1	1.2
1966	113.6	56.5	57.1	73.0	42.4	30.6	11.3	9.1	2.2	175.4	89.8	85.6	80.3	44.7	35.6	95.2	45.1	50.1
1965	95.8	45.5	50.3	67.6	37.8	29.8	9.5	7.1	2.4	153.9	76.1	77.8	78.4	42.2	36.2	75.4	33.9	41.5
1964	73.4	39.2	34.2	66.9	37.1	29.8	8.9	6.6	2.3	131.2	69.5	61.7	75.0	40.4	34.6	56.1	29.1	27.0
1963	49.9	28.8	21.1	52.3	28.8	23.5	9.5	6.9	2.6	92.5	50.5	42.0	76.4	41.4	35.0	16.2	9.2	7.0
1962	30.5	17.9	12.6	53.6	29.2	24.4	11.9	7.9	4.0	72.0	39.0	33.0	79.1	42.2	36.9	(7.0)	(3.2)	(3.8)
1961	17.3	17.8	(0.5)	64.5	35.6	28.9	9.6	6.8	2.8	72.1	46.4	25.7	81.2	42.9	38.3	(9.0)	3.5	(12.5)
1960	20.4	4.2	16.2	68.6	39.8	28.8	11.2	7.9	3.3	77.8	36.1	41.7	84.6	43.9	40.7	(6.8)	(7.8)	1.0
1959	53.8	29.8	24.0	58.7	30.0	28.7	10.0	7.6	2.4	102.7	53.2	50.4	87.0	45.0	42.0	15.7	7.3	8.4
1958	23.5	11.7	11.8	85.9	45.6	40.3	11.1	8.3	2.8	98.3	49.0	49.3	90.6	45.4	45.2	7.6	3.5	4.1

[1] Pro forma, 1958–67.

Source: Moody's Transport Manual.

Fiscal Policy

The spotlight is now thrown on fiscal activities to catch a glimmer of their relationship to the financial fortunes of the companies. Fiscal policy assessment is difficult because it is so closely intertwined with other internal activities and with outside market forces. The ultimate purpose is to weigh the impact of decisions in this policy area on the financial decline. While specific measurement is beyond reach, achieving perspective is attainable. This discussion provides a particularly important link in the overall analysis since constrained fiscal policies serve in turn as constraints on management decisions in other substantive areas.

This assessment considers first the constraints that condition the formation and implementation of fiscal policy. In the light of these constraints, policy in several key areas is examined, including investment programs, how they were financed, the reporting of earnings, cash management, and dividend payout. This selective treatment is based on potential contribution to bankruptcy, dealing generally with aspects of fiscal policy that have received public attention. Diversification is singled out for separate attention in a subsequent discussion.

This does not, in other words, purport to represent the definitive history of recent fiscal policies of the Pennsylvania and New York Central Railroads. Frequent comparisons between the PRR and the Central are made since their somewhat different approaches to fiscal policy, as well as other aspects of business and of railroading, permit an evaluation of the results of diverse policies.

CONSTRAINTS

The constraints which are important for this discussion can be meaningfully sorted into three classes: (1) inherited, (2) merger induced, and (3) those dictated by outside factors.

Inherited constraints are created by previous policies and events which themselves are the results of constrained managerial choices—and so on back to the beginning. In a sense, this inherited class raises the age old question of free will—the hand that is dealt and how it is played. Since this is a fairly open-ended category, it must be closely limited to the more explicitly relevant influences—the fixed charges and debt laden capital structure resulting from the postwar investment program.

The merger induced constraints are also a mixture of free will and necessity but with less rigid restrictions on options. Limitations were not generally absolute, decision makers could accept penalties as an option. One important fiscal policy constraint in this category is the agreement by the two companies in the merger terms to limit the amount of debt increase incurred to \$100 million. The limit was later raised to \$195 million, but it was still restrictive. Another is the agreed ratio for exchanging the stock of the two companies for that of the merged company. Under this arrangement, PRR stockholders were to receive one share and NYC owners 1.3 shares of the new company for each of their shares. It was incumbent upon each management to maintain earnings which would not disturb the ratio. The merger related constraints deserve special attention because of the long and totally unexpected delay between the time the merger was proposed and its approval.

The constraints dictated by outside factors that are of particular relevance here are, from a fiscal policy viewpoint, virtually absolute. Of great importance is the severely limited earnings performance of the two companies which restricted both the range of investments that could be undertaken and the means of financing them. Financial market conditions also exerted a strong influence, with money rates and inflation particularly potent in the late 1960's just when borrowing was badly needed.

Less rigorous but also important are financial market assessments of credit worthiness and security values. These factors are at least partly affected by fiscal stewardship, but they are significantly controlled by outside market forces. A related force is the effect of stockholder pressure or financial options.

INVESTMENT PROGRAMS

The capital investment programs separate into two categories representing commitments to the rail plants and operations and outlays for outside investment purposes. The latter category involves the well publicized diversification program of the Penn Central and is associated with the critical non-operating income examined earlier. This aspect of fiscal policy is covered in detail in a later section. This review focuses on investment in the railroad plants, comparing the magnitude and character of the plant investments of the two companies and providing a picture of their capital budgeting policies.

Maintenance outlays are included in the investment discussion for some purposes because of special functional relationships. Each is discretionary within broad limits and they serve as both complements and substitutes. Together they largely determine the capital raising tasks of fiscal management and thus sharply condition the main outlines of fiscal policy.

Investment patterns

During World War II these railroads, along with the others, were used very intensively with inadequate repair and replacements and so roadway and equipment deteriorated badly. It has been argued that the plants were never restored to their prewar condition. Comparative evidence indicates rather clearly that these two companies fell behind the system as a whole and most individual companies throughout the country in rehabilitating and improving the physical plant.

Railroad investment patterns fluctuate broadly with income and other variables as a reflection of their discretionary character. The result is a sawtooth pattern for the two companies and for the system as a whole (Charts B–1, 2, 3). Investment in roadway and structures, however, shows far more stability than in equipment (or rolling stock). The two companies' investment troughs are noticeably wider and deeper than the total system has experienced.

Although the specific movements are a little different, the investment patterns are generally similar for the two companies. The similarity includes a postwar peak followed by a sharp drop, a feeble revival in the mid to late 1950's, an early 1960's trough, and a last gasp effort prior to the fall. Through it all, the PRR program operated at a higher absolute level and held up a little better in the fluctuations (Table B–1).

The general sweep of the investment programs emerges from summary figures for two 10-year periods, 1948–57 and 1958–67 (Table B–2). The PRR total jumped from $986 million in the first period to $1,209 million in the second, an increase of $223 million or of about 23 percent. The Central's total, on the other hand, dropped from $895 million to $552.5 million, nearly 38 percent. Viewed in combination, the sharp NYC drop meant an overall decline of 6.4 percent. During the two periods, the PRR invested $2.19 billion and the Central $1.45 billion, a grand total of $3.6 billion and a difference of $747 million between the two railroads. Most of the difference was accounted for by the heavier PRR outlays for equipment in the second period, totalling $948 million.

These figures portray a pattern of relative deficiency. Measured as a percentage of operating revenues, the combined commitment paralleled the Class I railroad's performance, but was far below the achievement of many other major roads (Table B–3). Essentially the same pattern persists when relative performance is measured by the ratio of capital expenditures to gross investment.

Maintenance figures for the same time periods and plant elements overpower the investment levels so that interdependencies are badly obscured. The little light that is available here is drawn from the percentage relationship between the two outlay types. The pattern shows a high degree of stability, suggesting that maintenance behavior does not explain the different investment

patterns of the companies in the two time periods. The Central's maintenance expenditure for way and structure was 46 percent of the combined total in 1948–57 and 45 percent in 1958–67. Central represented 41 percent of the aggregate equipment outlay in the first period but 43 percent in the second. This two point difference represents $54.9 million, or an annual average of about $5.5 million, not a significant offset to the Central's lower rate of investment in the second period.[1]

The merged companies' capital investment program, including leasing, continued in 1968 and 1969 at a level slightly above the expenditures of the combined roads in 1967 but well below their 1966 figure. The comparative figures are as follows:

Year:	*Investment*
1966	$216, 385, 400
1967	137, 166, 100
1968	147, 187, 700
1969	151, 548, 900

The post-merger outlays were particularly modest in view of the specialized merger requirements that were imposed. They were supplemented, however, by extraordinary maintenance expenditures which increased from $421.0 million in 1967 to $427.6 million in 1968 and then on to $473.3 million and $551.3 million in 1970.

Capital expenditures related to the merger were a serious problem for the Penn Central. Merger plans estimated merger-related capital expenditures in the four years following the merger at $74.7 million but $90.2 million was required just in the first two years. Miscalculations are exemplified by the $20 million cost over-run for the new Alfred E. Perlman Yard at Selkirk, New York, and the $22.4 million required for a new classification yard at Columbus, Ohio, that was totally unanticipated.

Investment policy

The investment patterns outlined reflected policies adapted to the financial conditions facing management. In the PRR case, they emerged in the face of conflicting pressures and criteria imposed by concern for fiscal measures and performance to support high credit standing and for operating requirements for plant improvement. Management clearly tried for many years to compromise these two pulls.

The PRR's governing approach to plant investment was articulated in an internal document as early as 1954 which expressed concern over unfavorable stockholder reaction to additional investment commitments following the rather large postwar surge:

> From an overall standpoint it also seems to us that we must, where possible, adopt a middle-of-the-road policy on capital expenditures, doing this gradually, because it is apparent from the letters we have already received that the stockholders are highly critical of the fact that we have spent such vast sums of money on the railroad. If we spread out the program it is going to be much less criticized.[2]

Nearly 10 years later top management was reaffirming this middle-of-the-road policy regarding capital expenditures. Road expenditures occasioned particular concern since the required funds had to be generated out of earnings. It was believed that uncertainty about the railroad's future in light of such developments as piggyback, unit trains, the St. Lawrence Seaway, passenger deficits, and particularly the proposed merger and resulting changes in traffic patterns, dictated a conservative policy toward capital expenditures and maintenance. It was stated that:

> Lack of earnings and limited cash flow during the past 4 years, plus the necessity for continuing our debt reduction program in order to bring 1965 maturities within manageable proportions, has precluded any consideration of major capital expenditures for roadway projects.[3]

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[1] Moody's Transportation Manual.

[2] Memorandum, DCB [Bevan] to JMS [Symes], January 21, 1954; see appendix D, Exhibit 47, p. 610.

[3] Memorandum, Greenough to Symes, May 1963.

Although operating officers recognized the financial constraints, they frequently complained about the inadequate maintenance and the deteriorating quality of road and equipment and urged a reversal of this pattern. Finally in 1964 demands for a larger capital budget were granted on the basis of a minimum 30 percent return, or a $50 million operating profit. In the three years 1964–66 the PRR invested approximately $132 million in road and $372 million in equipment (excluding leases) or a total of $504 million, compared to $171 million in the previous three years.[4] However, operations fell short of the promised $50 million profit by $21 million in 1964 and $22 million in 1965.

This experience confirmed Bevan's conviction that the railroad could not generate an acceptable return on new capital investment. In his view, the result of the last program was simply to "increase system debt by $240 million and interest charges by $17.5 million," further straining the deficit cash position and damaging the company's credit with the investment community.

The 1964–66 capital budget program and Bevan's reaction to it intensified the discord between the operations and financial departments. Operations complained that the primary concern was "the risk of a decrease in our Moody's rating" and blamed cash deficits on non-rail investments. "If the question is what has happened to our cash, there is no reason to single these [plant investments],out from our non-railroad investments of all types over the past few years.' Bevan was accused of "the absence of a sense of common purpose" and of using operating properties as a cash source for large-scale diversification, although this policy was favored so long as the cash it required did not "make it impossible to profitably operate the $2.6 billion of assets sunk in the railroad." Operations spokesmen accused the financial community of being "more concerned about an increase in our debt than an adequate capital program." The contentions regarding cash drains are examined later.

In the financial view, Bevan asserted that despite the desirability of the investment objectives, excessive outlays in 1964 and 1965 impaired the company's ability to carry on new financing. The company was experiencing "an acute shortage of cash and high maturities in relation to depreciation" and had to be allowed "a breathing spell . . . until the operating people can show a satisfactory return on capital expenditures already made."

In 1967 capital programs were deferred and cash spending was limited until consummation of the merger between New York Central and Pennsylvania Railroads. On the eve of the merger, the Pennsylvania had no road capital expenditure budget for the ensuing year and the status of the equipment budget was still up in the air. Bevan put a stop to all future projects that did not show a 50 percent return on investment unless required for safety or for industrial development purposes.

The financial officer's anguish shows clearly in this statement of ultimate disillusionment:

> The equipment financial situation is very serious. Over a long period of years it can be easily demonstrated that the P.R.R. spent (whether wisely or not) more money on its equipment than any other railroad in the United States. As a result, we are approaching a very serious situation where our annual equipment maturities very quickly are going to equal or exceed not only our equipment depreciation, but our total depreciation. This is almost unheard of in the railroad industry and unless corrected promptly will do more to hurt our credit than almost any other factor. If our credit is damaged this, in turn, will have a very serious and substantial effect on the value of our stock.[5]

Investment policy evaluation

Evaluation of some aspects of investment policy requires a consideration of other factors. In some respects, definitive evaluation cannot be provided and only limited observations are advanced at this stage. The central question is whether additional investment funds could and should have been provided for

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[4] ICC Form A, Railroad Annual Report.

[5] Memo from Bevan to Saunders, October 22, 1965; see Appendix D, Exhibit 48, p. 612.

the rail operations. Along with the foregoing policy statements, this summary is confined to the PRR, although the underlying financial stringency and the low returns were prevalent in the Central as well.

Unquestionably, financial stringency severely limited the availability of funds for plant upkeep and improvement. In reviewing investment activity, it requires emphasis that the avowed policy was "middle-of-the-road" and not geared to financial starvation. During the years 1959–1967, over $1.5 billion was put back into two companies that were able to generate only $472.5 million of Net Railway Operating Income (NROI). This investment was nearly 10 times the amount put into diversification during the period 1963–70.

Aside from recognizing that replacement funds, restricted by low earnings, were negligible by most standards, the fundamental question of the economic rationale for additional investment requires consideration even though it cannot be answered satisfactorily. Investigation does not reveal a comforting capital budgeting process, but rather an *ad hoc* system of compromising conflict.

There is no apparent firm and rational basis for either project justification or evaluation. Bevan declared himself displeased with proposals, indicating on one occasion that "there are so many discrepancies in the proposed program that it appears that figures have almost literally been picked out of the air."[6] Nor can his position be contested that, in later years particularly, projects did not earn justifiable returns. But while there is no evidence that projects with promising returns were passed up, the record still leaves some puzzling questions centering around the capital budgeting rules. It has been said that PRR's equipment investment decisions were controlled by narrow cost cutting criteria with inadequate regard for other benefit sources. Particularly fascinating were projects permitting personnel reductions, a laudable aim perhaps but hardly acceptable as an exclusive investment project criterion.

The 1964–66 program was considered a failure by Bevan since it did not immediately produce such delights as a $50 million profit contribution or a 30 percent return. One can only wonder about the rationale for the criteria and the stringent payoff period expected.

On the other hand, meeting fiscal goals was critical. Excessive debt and other unfavorable indications meant a credit weakening and higher capital costs. Given the financial stringency, the insatiable appetite of the plant, and the legacy of past obligations, steering a safe course between the fiscal and operational shoals by these large Eastern railroads during the 1960's was a fierce and perhaps impossible challenge.

CAPITAL STRUCTURE AND FINANCING METHODS

Financing policies are mirrored in capital structures which reflect the relationship between debt and shareholders' equity. The long-term debt of both companies advanced rather substantially during the early postwar years. The Central jumped from $632 million in 1948 to $835 million in 1953, an advance of $203 million or 32 percent. The PRR increased to its 1952 maximum of $831 million by a more modest $154 million or 23 percent. After remaining rather steady at the new level for several years, the Central's debt dropped 23 percent after 1957 to a new low of $633 million in 1964. The PRR, on the other hand, turned downward immediately after the 1952 high, dropping every year to reach a new postwar low of $563 million in 1964, off $248 million or 31 percent from the 1952 high. During these postwar years, the PRR debt rose less and dropped more and faster than was true for the NYC (Table B–4).

After the 1964 lows experienced by each company, however, the behavior patterns were completely reversed. The NYC debt advanced rather mildly from $633 million to $666 million, while the PRR jumped from $563 million to $721 million; up $158 million or 28 percent. These upward movements established patterns that were continued and enhanced after the merger. The result was a whopping 59 percent increase to 1970, staged as follows:

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[6] Memo from Bevan to Saunders, October 22, 1965; see Appendix D, Exhibit 48, p. 612.

[In millions of dollars]

Year	Long-term debt	Annual increase
1964	1,196.0	
1965	1,301.1	105.1
1966	1,346.7	45.6
1967	1,387.2	40.5
1968	1,606.9	219.7
1969	1,859.4	252.5
1970	1,901.8	42.4

The equity portion of the capitalization is somewhat more stable than the debt element. This is demonstrated in the following 5-year summaries:

CAPITAL STRUCTURES

5-YEAR AVERAGES

PENNSYLVANIA, NEW YORK CENTRAL; 1948–67

	Pennsylvania					New York Central				
Period	Current liabilities plus long term debt (millions)	Long term debt (millions)	Equity (millions)	Current liabilities plus long term debt/equity (ratio)	Long term debt (ratio)	Current liabilities plus long term debt (millions)	Long term debt (millions)	Equity (millions)	Current liabilities plus long term debt/equity (ratio)	Long term debt/equity (ratio)
1963–67	$810.7	$635.5	$1,374.8	0.59	0.46	$782.2	$652.0	$926.8	0.84	0.70
1958–62	788.5	656.8	1,387.9	.57	.47	834.1	719.2	947.0	.88	.76
1953–57	888.0	749.9	1,387.6	.64	.59	953.5	825.3	945.0	.95	.87
1948–53	896.5	738.9	1,306.0	.69	.56	835.6	703.3	873.9	.95	.80

Source: Moody's Transportation Manual.

Equity increased modestly for each company between the 1948–52 and 1953–57 periods (6 percent for PRR and 8 percent for NYC), with a high degree of stability thereafter. As a result the significant debt/equity ratio is largely sensitive to debt fluctuations and thus follows the contours laid out above. Including current liabilities in the debt component raises the ratios by roughly 10–15 points, but does not appreciably effect the contours (Table B–4). The ratios generally increased to 1952 and then fell back in response to the debt reduction programs.

Equity growth, however, continued to bring the Central's long-term debt/equity ratio down even after the debt upturn in 1964, reaching a low of .67 in 1966 before bounding up to .80 in 1967 in response to a small increase in debt coupled with a sharp drop in equity (off $145 million). The PRR ratio turned upward after the 1964 debt trough, jumping from .40 in that year to .57 in 1967. Building on the predecessor trends, the Penn Central started life with a lusty .79 in 1968 and then jumped to .97 and 1.27.

Long-term debt figures and their relation to equity are underestimated in recent years because of the increased use of equipment leasing. As elaborated later, since the value of leased equipment is not capitalized, the real debt and debt-equity ratios are larger than shown.

The historical differences in the capital structures of the two companies feature the Central's heavier reliance on debt financing (Table B–4). The differential reached 24 points in the 1948–53 period, advanced to 33 points in the next 5 years, and fell off to 29 points in 1958–63 in response to the debt reduction programs. Movements of controlling variables in the 1963–67 period brought the differential back to 24 points. Throughout the entire 1948–67 period, the NYC ratio ranged from 67 to 91, while the PRR stayed within the 40 to 62 bounds. Despite a smaller asset and revenue base, the Central's debt actually exceeded the PRR's throughout the 1953–65 period.

The debt/equity ratios of the two companies may be put in perspective by reference to ratios for all Class I railroads (Table B–5). In general terms, the PRR generally stayed below the system average and the NYC well above. The PRR was only slightly under in the 1953–57 period, with a 5-year aver-

age ratio of 54 compared with 59 for the system. The spread was increased to 10 points, however, in the two subsequent 5-year periods. The all system average remained very stable in the upper 50's while the PRR figure was dropping. The NYC, on the other hand, maintained an 87 average in the 1953–57 period against the all system average of 59. Even with its subsequent drops to 76 and 70, it remained on the high side by 15–20 points.

DEBT BURDEN

Since railroad earnings are rather volatile, a safety margin is needed for successful debt management to insure annual income sufficient to cover fixed charges and to provide a flow of funds to meet debt maturities. Not having these essentials, debt management for the PRR and NYC was precarious.

The major debt movements included (a) the postwar buildup, (b) the debt reduction program to 1964, and (c) the PRR buildup in conjunction with the NYC plateau. The early buildup was required for the postwar renovation of the two plants. The fiscal legacy was a formidable schedule of maturities and a burdensome level of fixed charges that practically drove the Central into bankruptcy and created serious concern regarding the credit standing of the PRR.

The burden imposed on earnings by the debt load is most directly measured by the ratio of the income available for fixed charges to fixed charges. In spite of debt retirement and declining fixed charges after 1952–1953, the average ratio of income available declined, demonstrating the crucial role of the income factor (Table B–6). Furthermore, the ratio patterns of the two companies were remarkably similar despite quite different debt policies during the 1960's. Available income was less than fixed charges in 1960 for the Central and 1961 for the PRR. The Central maintained higher ratios in the earlier years but the gap was subsequently closed and it fell behind in the last period shown in this summary.

Period	New York Central	Pennsylvania Railroad
1948–52	1.56	1.24
1953–57	1.65	1.40
1958–62	1.01	.98

However, the figures for recent years must be carefully interpreted because of the increased use of leasing. Viewed as a form of long-term debt, equipment leasing approximates a serial bond. The cash outflow in any given period would represent a payment of interest plus a payment for the current maturity of the debt. With leasing, the periodic lease payment represents the equivalent of a repayment of the principal (which should approximate the depreciation charge that would have been incurred if the equipment were owned by the railroad) plus a payment for imputed interest. Interest is included in lease payments as a fixed obligation like any other type of debt. Under leasing however, depreciation and fixed charges are reduced and rent payments are increased. Both income available for fixed charges and fixed charges are thereby reduced, producing better ratios of income available to fixed charges than with equipment financing by conditional sales agreements or equipment trust certificates.[7] Since PRR increased its leasing relatively more than Central, its ratios are actually overstated in comparative terms. These ratios also are distorted by the accounting practices which inflated (maximized) reported earnings. This policy, which will be dealt with more extensively later in this section, created a divergence between reported income and true cash flows. The ratio of income available for fixed charges to fixed charges is designed to measure the ability of the railroad to pay its fixed obligations from earnings. In the case of the PRR, and later the Penn Central, the coverage of fixed charges ratio was inflated by the earnings maximization policy.

The related problems of meeting debt maturities also plagued the PRR in its last years. Along with the increased fixed charge burden associated with

[7] Except when the ratio is less than one and the true ratio is over estimated.

the 1964–66 capital improvement program, heavy maturities were coming due beginning with a $52.9 million issue of 1965 and another of $84.7 million of 1968. The Central escaped these debt problems at this time by keeping capital expenditures at a minimum and deferring any substantial maturities until the 1970's. Bevan estimated that in 1967 maturities would approximate $57 million compared with estimated equipment depreciation of $35 million and road depreciation of $19 million, all devoured by the maturities. This violated the rule of thumb limiting maturities to equipment depreciation and had begun to cause adverse comment in the investment community. By contrast, the Central's 1967 depreciation was estimated at about $30 million to cover only $20 million of maturities.[8]

The debt reduction programs of the companies reflected expectations that future revenues would provide inadequate funds to meet obligations. The programs were accomplished by paring down debt obligations of rail operations and greatly curtailing maintenance. Credit standing was reestablished in the early 1960's but the effect was short term and by 1968 the Penn Central's debt/equity ratio was the highest it had been since the late 1940's for the composite companies.

EQUIPMENT FINANCING

Rolling stock or "equipment" constitutes the major component of railroad plant investment. Aside from any production function dictating relative requirements for equipment and for roadway capital, investment in equipment is encouraged by the greater availability of funds because of more favorable financing methods. Investments in roadway plant can be secured only by general mortgages, while liens on resalable equipment provide greater protection for lenders. However, even this advantage can be seriously diluted for companies with doubtful credit, as the PRR and NYC discovered. Thus, while equipment financing is rather straightforward under ordinary circumstances, credit availability, capital costs, and repayment potential can create complications.

Three general methods of financing new railroad equipment, other than outright purchase, are available: (1) sale of equipment trust certificates, (2) conditional sales financing, and (3) leasing. The traditional method for the railroads had been equipment trust certificates, but in the mid 1950's the railroads (especially PRR) began to rely more heavily on conditional sales agreements and on leasing.

In equipment trust financing, railroads make a 20 to 25 percent down payment on the equipment and then finance the balance of the expense by the sale to the public of equipment trust certificates. The certificates are usually repaid serially over 15 years and the owners have a lien on the equipment through the equipment trust. The interest rates on the certificates are generally below the interest rates on high grade utility bonds. In railroad accounting, equipment trusts are listed as long-term debt on the balance sheet (except for the amount due within the year, which shows up just below current liabilities) and interest on them appears as fixed charges on the income statement.

Conditional sales agreements are installment loans backed by promissory notes usually payable within 10 to 15 years and possibly requiring a down payment. The lender retains title to the equipment until the note is repaid which makes repossession easier than with equipment trust certificates. Originally financed by banks, in recent tight money years railroad conditional sales contracts have depended on pension funds, insurance companies, and savings institutions. Railroad accounting treats conditional sales contracts exactly as it does equipment trust certificates.

A cited advantage of conditional sales agreements for a cash short railroad is the elimination or spreading out of the down payment. However, this is a questionable advantage since a higher debt in one area may weaken the railroad's ability to borrow elsewhere. It should also be noted that deferring the down payments caused larger payments of principal and interest in later years, an option consistently selected by the PRR and later by the Penn Central. A disadvantage of conditional sales contracts is a somewhat higher interest rate.

[8] Memo, from Bevan to Saunders, October 25, 1966; see Appendix D, Exhibit 36, p. 554.

Because of easier repossession, conditional sales contracts are usually easier to obtain than equipment trust financing in tight money periods and for firms with unimpressive credit ratings, but at the expectable cost of higher interest rates.

In leasing, the lessor retains title to the equipment and the railroad contracts to make regular payments for its use spread over the economic life of the equipment. Like 100 percent conditional sales contracts, leasing gives the questionable advantage of avoiding a down payment. Since the leases were not financial leases, accounting practice provides that their capitalized values are not long-term debt nor are interest payments listed as fixed charges. Lease payments are reported along with per diem rental to other railroads as "hire of equipment—debit." A switch from equipment trust or conditional sales financing to leasing gives the illusion of a reduction in the railroad's long-term debt and fixed charges while not improving its ability to meet contractual obligations. However, if investors and creditors accept the illusion, the railroad credit position may be improved. Like a conditional sales agreement, leasing carries a higher implicit interest rate than equipment trust financing, but is easier for a firm with weak credit to obtain because the lessor retains title to the equipment.

The New York Central relied primarily on equipment trust financing until 1954 when its credit rating dropped from A to Baa. It subsequently resorted infrequently to equipment trust financing until the 1960's, turning mainly to private financing through conditional sales agreements. The conditional sales agreements carried a higher rate of interest (at first under five and sometimes under four percent) but apparently equipment trust financing was more difficult to obtain because of the lowered credit rating. In 1956, the Central shortened some conditional sales contracts to 10 years from the traditional 15, making the contracts more attractive to lenders but also causing larger cash drains in the tight money period of the late 1960's. The Central did not use leasing until 1962.

The Pennsylvania relied primarily on equipment trust financing until 1957 when it turned to conditional sales contracts and leasing, with leasing particularly favored. Approximately $248 million worth of equipment leases were added during 1958–60.[9] An apparent reason for the shift was the large drop in income in 1957 and the years following. This meant, first, that the railroad needed to conserve cash (and these two methods meant smaller or no down payments) and second, that its weakened credit position made equipment trust financing more difficult. Leasing was also favored because it did not increase the reported debt structure, an advantage only if creditors failed to evaluate the effect of leasing on the railroad's ability to meet contractual obligations. After 1962, leasing provided a means to circumvent the merger agreement on debt limitation.

The Central did not follow the leasing path so extensively. The ratio of lease payments to other car rentals during the 1960's stayed around 0.10 for the Central, while it was commonly 0.30–0.40 on the PRR, but began dropping off by 1967 (Table B–7). Leasing and conditional sales agreements were also the major means of financing equipment acquisition after the merger.

It appears in retrospect that the companies were shut off from major reliance on equipment trust financing by low earnings and reduced credit ratings. The resulting higher interest rates were beyond their control given their earnings records and the tight money market conditions. Even the Central's retroactively questionable decision to switch from 15-year to 10-year conditional sales contracts may have been forced by lenders demanding shorter terms because of the low credit rating.

In order to evaluate the effect of different types of financing on cash flow one would have to make a careful study of the amount and timing of the initial down and annual payments, and of relative contract periods. But there is no reason to argue *a priori* that leasing was a poor method of financing equipment. It was clearly a reasonable alternative considering all of the circumstances.

Another aspect of fiscal policy associated with equipment financing involved the choice of rebuilding old freight cars instead of purchasing new ones. By

[9] See Table, "Equipment Lease Agreements," Appendix D, Exhibit 49, p. 614.

1962, the PRR was following the refurbishing route extensively. Because of the twilight zone between purchase and rebuilding and between rebuilding and maintenance, significant accounting and financing questions are involved.

Freight cars normally require major overhaul every 12 years. This may involve rebuilding, increasing capacity, or adding specialized equipment. In the years just prior to the merger the PRR began capitalizing some of these expenses and the practice was continued by the Penn Central. The ICC Bureau of Accounts argues [10] that even when rebuilding is involved, capitalization is usually improper and the costs involved should be written off as maintenance expenses in the year of the rebuilding.

Capitalizing these expenses can be justified in accounting theory if rebuilding a car substantially changes the quality of service it will provide. While it is not clear that the maintenance expenses were of this type, the switch to a capitalization basis, in the short-run at least, reduces reported maintenance expenses and thus increases reported net income.

In this equipment rehabilitation process, PRR sold the cars to straw parties (usually railroad employee groups or financial institutions) designated as "owners" who would contract with the railroad to make the repairs. The costs were reported in an "Owners Equipment Fund" separate from the regular railroad accounts. After completing repairs, the "owners" would sell the equipment to an affiliate of the railroad which made a 10–15 year leasing contract with the railroad that then would be assigned to a bank or other financial institution.

There were three apparent reasons for capitalizing the equipment repairs. First, this procedure increased reported income as described above. Second, by leasing the equipment back, the cash drain in the year of the repair was reduced from the amount of the repair to the amount of the first lease payment. However, the saving in cash in the first year meant larger cash drains in following years. Finally, capitalizing the rebuilding expenses permitted use of the investment tax credit. Since the Penn Central was not earning enough to pay taxes, the investment tax credit was not a direct benefit, but selling rebuilt freight cars to financial institutions permitted the tax credit advantage and thus encouraged more favorable credit arrangements for the railroad. But whatever the balance of benefits and disadvantages, capitalization's direct effect was lower reported maintenance costs than if this item were treated as an expense. The associated result is discontinuities which cloud trends and comparisons in such critical series as fixed charges, maintenance, and investment.

While reducing short-run cash outflow, the practice deceptively increased reported net income.

POST-MERGER FISCAL POLICY

In the nearly two and a half years between the merger and bankruptcy, interest rates skyrocketed while the Penn Central suffered gigantic operating losses. The railroad relied progressively more on short-term borrowing and by the time a long-term debt offering was initiated it was too late. The railroad's financial difficulties had become too obvious for the debenture offering to be a success and the railroad was forced into bankruptcy.

Aside from equipment financing through conditional sales agreements and leasing, two principal financing sources were revolving bank credit and commercial paper, supplemented by the Eurodollar market and debt offerings of the Pennsylvania Company. The revolving bank credit borrowing was brought up to the $100 million limit by the summer of 1968. It was then extended to $300 million under the aegis of the First National City Bank of New York, but under more stringent arrangements, including the strict maintenance of offsetting bank balances. This additional source of capital was immediately tapped.

The ICC approved Commercial paper issues up to $100 million. This amount was sold in the second half of 1968, followed by a further authorization and sale of $50 million in March 1969 and $50 million in November 1969, for a total of $200 million. Commercial paper, favored because of its ostensibly lower interest

[10] Interstate Commerce Commission, Docket No. 35291, Penn Central Investigations Verified Statement 36, pp. 46–50.

rate, actually bore rates exceeding the prime rate in 1969 and 1970 because of its heavy use. It is also dangerous because of its extremely short-term status, with the real threat of inability to roll over the loans, which was the precise fate of the Penn Central. Between April 21, 1970 (the day preceding the announcement of operating results for the first quarter of 1970) and May 22, 1970, maturities of commercial paper exceeded sales by $78 million.

The post merger financing program also included a new long-term blanket mortgage of $200 million to $300 million which was to become the major long-term debt vehicle for the Penn Central. The proposal was to issue an overall blanket mortgage to refinance maturing bonds and to provide funds for further capital expenditures. The bonds would also enable the company to reduce or eliminate its commercial paper and to pay back the revolving loans, and this credit line would then continue as security for emergency cash needs. To avoid tying nonrail properties to the blanket mortgage, the plan was to pledge all of the system's strong first mortgage bonds that were available.[11] Unencumbered properties were to be mortgaged and already mortgaged holdings would be further encumbered to the extent possible, all placed under the new blanket mortgage. Legal and mechanical complications delayed the offering. By the spring of 1969, there was little market interest in straight debt of such magnitude, and the Penn Central was apparently unwilling to issue convertible bonds.[12] But it is doubtful that even with a better bond market the Penn Central could have made a successful bond offering given its tremendous operating losses.

Forced to give up the Penn Central mortgage bonds, two issues of bonds were made in 1969. Still in desperate need of funds, on April 24, 1970, the Penn Central through the Pennsylvania Company announced a proposed offering of $100 million in sinking fund debentures to be due in 1995, with warrants half exercisable for Great Southwest stock and half for the new Penn Central holding company.

The banks apparently indicated some concern before the April announcement over the railroad's continuing poor operations and questioned its ability to pay off the bank loans.[13] Nevertheless, they lent the Pennsylvania Company $50 million in revolving credit on January 27, 1970 "to proceed with its orderly financing program." These funds were to be moved "upstairs" to the railroad in return for some "income producing assets." On May 29, 1970, when the bankers for the offering could not attract sufficient support for half that amount at interest rates of as much as 11.5 percent, the offering was withdrawn. Cessation of the offering caused havoc in financial circles and the Penn Central management turned unsuccessfully to government officials for financial assistance.

A review of the post-merger financing policy of the Penn Central shows that short-term financing was being used for long-term problems. The resulting interest costs to the railroad and the problems of rollover were enormous, given the very tight money market and the railroad's operating losses. By the time long-term financing was attempted the railroad was in such bad financial shape that the offering failed.

With the gift of hindsight one can argue that the railroad should have realized it would have serious operating losses in the first few years and should have arranged long-term financing at the time of the merger. The most appropriate type of financing would have been a stock offering. Although equity financing is the most expensive form of capital, the price-earnings ratio was very high at the time of the merger because of expectations about merger savings making this financing method somewhat less expensive than usual. Equity financing also would have given the railroad a much needed margin of safety by providing

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[11] For example, the properties of the Pittsburgh and Lake Erie which were 93 percent owned by the Penn Central were not then mortgaged, nor were the 100-percent-owned Fort Wayne properties.

[12] James O'Brien of Salomon Brothers wrote about the long-term bond market to Jonathan O'Herron in September 1969:

"With reference to your recent inquiry it is our considered opinion that in the light of the present condition of the bond market and the scarcity of long-term bond money among institutional investors, it would not be feasible or practical to contemplate an offering of $50 to $200 million PC long-term mortgage bonds at this time on either a negotiated or competitive basis."

[13] "Management has indicated they are willing to pay whatever price it will take to sell the $100 million issue in the Pennsylvania Co. and should be able to meet our interim loan. What bothers us is that they are slowly using up their debt free assets to pump funds into the railroad. This can only go on so long and should the railroad continue its poor operation for several more years, our direct loans would be seriously jeopardized." (January 11, 1970, memo from Chase Manhattan Bank.)

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capital without increasing fixed charges. Six months after the merger equity financing probably would have been difficult if not impossible. The detailed information required on a prospectus would have shown that costs had skyrocketed and service had deteriorated.

ACCOUNTING PRACTICE AND POLICY

It is appropriate at this point, prior to discussing "earnings maximization," to briefly mention ICC accounting policies and practices.[14]

The accounting policies and disclosure requirements of regulated common carriers are prescribed by the Interstate Commerce Commission. Such carriers are exempt from many of the provisions governing regulations of the Securities and Exchange Commission. In addition, such carriers are exempt from some of the provisions of the pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants, a committee responsible for promulgating "Generally Accepted Accounting Principles." The ICC's acknowledged hegemony in establishing the regulations and procedures best suited for the needs of common carriers is the reason for such exemption.

There can be definite advantages to such regulation. The consistency in reported financial performance from one accounting period to another and the uniformity of accounting practices among all regulated common carriers can provide excellent financial information to the carriers of financial reports. Furthermore, the ICC can prescribe policies and procedures with greater specificity than the Accounting Principles Board, which makes policy pronouncements for a much broader segment of the American industry. However, some extant policies and procedures prescribed by the ICC are in need of critical review so that the theoretical advantages of regulated accounting policies may be realized.

The existing ICC position on "betterment accounting", deferred income taxes, accounting of investments in subsidiaries, and financial disclosure requirements should be amended to reflect the increased complexity of the major common carriers' operations and the need for more relevant financial information by analysts and investors. The ICC's regulations presently lack precise requirements for certification of financial statements by independent accountants and standardized disclosure requirements for prospectuses. These regulations fail to obviate the sort of loose accounting practices evinced by the Penn Central Company's treatment of transactions designed primarily to inflate reported income on both a consolidated and non-consolidated basis.

The ICC must respond to the changing nature of the transportation industry by adopting and adequately enforcing accounting policies and procedures that reflect the needs of the carriers as well as of the users of such information, and would serve as a palliative for existing policy and enforcement inadequacies.

EARNINGS MAXIMIZATION

Earnings maximization is usually conceived as a behavioral phenomenon or as the goal doggedly pursued by entrepreneurs in the textbook economic models. It has a highly specialized and somewhat pernicious connotation here, being less concerned with substance than with appearance. It might best be described here as a policy of "earnings inflation." This concept of earnings maximization—or earnings inflation—is much less concerned with the realities of income building, founded on the solid rock of quality output, effective cost control, and superior marketing, than with chimeras. Earnings are thus "maximized"—or "inflated"—by pretending they are larger than they really are. There is, however, a range in this pretense—running from reasonable options of taking income all at once, or spreading it out, to pure fakery; accounting principles are both compromised and corrupted in the process. There are, to be sure, behavioral explanations for the phenomenon. Whatever the real distribution of these actions along the pretense scale, earnings maximization as it

[14] For a more thorough discussion of accounting matters see "Accounting Practices and Policy" in "Fiscal Policy Analysis" in Part III of this report.

emerged in this context of desperation is a sleazy concept that deserves the scorn it has received.

But righteously recognizing the shortcomings inherent in this charade doesn't help with the basic problem of assessing fiscal policy. The ultimate question is simply how the accounting games affected the longevity of the enterprise. Taking all you can get today on the idea that there may not be a tomorrow may, actually be a sound long-run strategy. Hiding a weakness may be prudent business if its exposure enhances vulnerability. On the other hand, departures from reality in these critical matters may be dangerous. It takes cash to run a company; the engine can't be fueled with paper and accounting entries. But this doesn't say that pretending there's cash when there isn't *causes* the lack. The questions to be asked are how dismal the picture would really have been without this exercise in optimism and the *real* effects of the flight from reality. As with many of the aberrations requiring examination, earnings maximization appears to have been a special pursuit of the PRR and the PC not pursued by the Central.

Earnings maximization has been partially explained as resulting from the desire of management to protect the 1.3 to 1 stock exchange ratio agreed upon in 1962. Two explanations may be offered for the premerger concern over the ratio. If the NYC ratio were increased the percent of ownership of the Penn Central going to former PRR shareholders would be less and renegotiation caused by an altered earnings picture might further delay the merger.

In order to avoid pressure to change this ratio, PRR management made adjustments to insure that Central's earnings and dividends per share were not more than 30 percent above the Pennsylvania's. Some associate the earnings inflation policy with the arrival of Stuart T. Saunders on October 1, 1963.[14a] In any case, it was sufficiently formulated to warrant Bevan's description in 1966:

> The policy may be instituted of maximizing earnings to the greatest extent possible within the limits of good accounting practices. In the last several years, this has been done on the Pennsylvania in accordance with your expressed desires. It does mean, however, that we tend to create a wider and wider difference as between reported income and cash flow. Today the cash flow of the Pennsylvania Railroad is substantially less than its reported income. We changed the basis of consolidation and, therefore, a substantial amount of earnings of subsidiaries are now included in our reported income but are not actually available to us from the standpoint of dividends.[15]

Concern for the position relative to NYC was expressed in frequent comparisons of Pennsylvania Railroad earnings with New York Central earnings and adjustments to reflect the exchange ratio. Concern about the relationship is also expressed in observations linking a subsidiary's dividend declaration to the PRR's quarterly earnings.

Earnings inflation continued after the merger, even though the ratio was no longer relevant, apparently to maintain the credit position of the railroad. More conservative reporting of income might have made it more difficult for the railroad to raise capital. (As with leasing to reduce the apparent debt structure, this assumes creditors take the reports at face value.) The need for increased earnings was given as one of the motives for the diversification program.[15a]

A number of devices were employed to inflate earnings statements. In 1965 the ownership share required for including a subsidiary in the consolidated income statement was reduced from 100 to 50 percent. (It should be noted that this action did not violate generally accepted accounting principles.) The included firms increased from 41 in 1964 to 100 in 1965 which brought in the

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[14a] Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation, Verified Statement 36, p. 31.

[15] Memo from Bevan to Saunders, November 21, 1966; see Appendix D, Exhibit 50, p. 616.

[15a] At the end of 1965 Bevan stressed to Saunders that sound nonrail acquisition would be necessary after the merger in order to maintain an upward earnings trend:

"The only way that we have been able to offset our failure to realize adequate operating income has been through the companies that we have recently acquired . . . there are also one or two other companies that should be acquired after merger if we are going to keep the trend of our earnings growing upward on an adequate basis."

earnings of the real estate subsidiaries (Great Southwest Corporation and Macco Corporation). These earnings accounted for a large portion of consolidated income but largely consisted of paper profits and little cash flow.

As another general approach, subsidiaries were required to inflate earnings and to pay large dividends to the Penn Central Transportation Co. to help swell its non-consolidated income statement. Forcing an earnings maximization policy allowed the Penn Central to report higher consolidated income from subsidiaries treated on a cost basis. After 1964 (the first full year of Saunders' tenure) there was a notable increase in dividends paid to the parent, with the 1968 and 1969 payments especially large although mostly not representing equivalent cash flows. This earnings maximization and dividends policy was damaging to the subsidiaries as well as misleading regarding the parent.[16]

Another device was to report as much income as possible as ordinary rather than extraordinary, which involved some questionable accounting practices. The most obvious example was the 1968 swap of Penn Central's interest in Madison Square Garden for 25 percent of the outstanding common shares of Madison Square Garden Corporation. In addition, book or market values were alternatively selected on the basis of which would state the largest income.[17]

The company also used a number of devices to reduce its reported expenses, both by altering real flows and by accounting manipulation.[18] As previously mentioned, a major element of control was the restriction of maintenance and capital expenditure budgets. These cutbacks to explicitly abet earnings goals started as early as August 1963 and were a paramount consideration thereafter.[19]

Expenses were also understated by capitalizing equipment refurbishing as previously described. On some occasions the company avoided retiring nondepreciable property because retirement would involve recording service losses as operating expenses. Many expenses were questionably classed as "extraordinary" expenses and thus placed below net income on the income statement.

In an illiquid company, cash management would seemingly be the major area of management concern, but the generation of cash itself was secondary to attempts to maximize reported net income. Normal liquidity analysis from published financial statements is of little utility because of the distortions in those statements occasioned by the singleminded pursuit of a "respectable" bottom line figure. Accounting theory stresses conservatism and consistency, but the former was ignored and the latter was followed only where reported income would be maximized.

The earnings inflation policy severely hampers analysis of the transportation company's cash flows because of its great and growing divergence from reported net income.

Since earnings maximization must be viewed in conjunction with a number of other considerations, it will be discussed again. It is clear that this practice posed some substantial issues affecting an array of matters ranging from operating effectiveness to cost of capital.

DIVIDEND POLICY

The Pennsylvania Railroad enjoyed a proud history of uninterrupted dividends payments. The New York Central's record was spotty, with recent skips in 1954, 1958, and 1961.

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[16] See for instance memo from William C. Baker to David Bevan, September 12, 1969; Appendix D, Exhibit 51, p. 618.

[17] The difference between the book value of the property and the market value of the stock was $21 million, which the Penn Central reported as ordinary income. If the $21 million had been treated as non-recurring and hence as an extraordinary item, the Penn Central would have had a deficit in ordinary income of $22.9 million rather than a deficit of $2.8 million. In 1969 the Interstate Commerce Commission required the Penn Central to treat the $21 million as an extraordinary item but the change was noted only in a footnote to the 1969 stockholders' report (Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation, Verified Statement 9, p. 5).

[18] For example, in July 1969 it sold Madison Square Garden stock to the Pennsylvania Co. at a book value of $11 a share although the market value was below $9. In March 1970 Penn Central sold the Pennsylvania Co. its stock in Clearfield Bituminous Coal Co. at its equity value of $16.9 million rather than book value of $82,200. The stock dividend of the Washington Terminal Co. to the Penn Central had a book value of $3 million but the Penn Central recorded the dividend at its appraised (but questionable) value of $13.5 million (Id. pp. 6–9).

[19] Another example is a mid-1967 memo stating that the PRR had "pushed credits and revenues to the limit . . . We have included everything that we can think of in the parent company and consolidated, and we know of no other steps to take from an accounting standpoint." The only way to improve quarterly earnings was "for very drastic cuts in maintenance, if this is feasible." See, memo from Bevan to Saunders, June 1, 1967, Appendix D; Exhibit 52, p. 623.

In the period 1952 to 1959 PRR dividends averaged 51 percent of railroad net income and 38 percent of its consolidated net income (Tables B–8, and 9) and by 1960–1967 these figures were 103 percent and 35 percent.[20] Although on a consolidated basis the Pennsylvania's payout ratio did not increase (it actually declined by 3 percentage points), these figures are deceptive. The consolidated income reported from 1960 to 1967 includes income of subsidiaries at least 50 percent owned by the PRR and, as indicated in the earnings maximization discussion, much of this income was merely "paper profits." In terms of cash available, therefore, the payout ratio probably increased significantly

The Central also registered an increase in dividend payout between the 1952–59 period and the 1960–67 period, jumping from 33 percent of railroad net income and 27 percent of consolidated net income to 73 percent and 47 percent. It is important to note here that while this appears somewhat more liberal than the PRR's dividend policy, comparison is nearly impossible because of the PRR's earnings maximization policy.

The payout ratio of dividends to net income for Class I line-haul railroads as a whole was 51 percent between 1952 and 1959 and 65 percent between 1960 and 1966. These figures indicate that the Pennsylvania and the Central paid out somewhat less than the industry average in the first period and more in the later period. However, the estimated average payout ratio for all Class I railroads is probably too high.[21] First, net income is ordinarily measured after extraordinary expenses while net income for the PRR and the NYC is before extraordinary expenses. Second, large losses by a few railroads would reduce total net income. (For example, the payout ratio of almost six times net income in 1970 is largely explained by the Penn Central bankruptcy.) With the payout rate for all railroads overestimated, the dividends paid by the PRR and the NYC in the 1960–67 period seem extraordinarily high.

The high premerger dividends may have resulted from a provision of the 1962 merger agreement which limited these payments to 25 cents a share for the PRR and 32.5 cents (1.3 times 25 cents) for the NYC or if higher, an amount derived by a complicated formula. In 1962, PRR paid 25 cents and NYC 32.5 cents a share and both increased every year thereafter (Table B–10). On the average the Central paid 1.10 times the dividend payments of the Pennsylvania on a per-share basis (Table B–10). Although no evidence was discovered in the railroads' records, it is possible that each company was defensively and reciprocally raising its dividends to maintain the 1.3 ratio.

Another reason for increasing dividends may have been to raise the market value of the stock. A high stock price might make the railroads look like good investments and impress their creditors.

The high PRR dividend of $2.40 in 1967 set the stage for the large dividends issued after the merger. In 1968 the Penn Central paid $2.40 or 60 cents per quarter. The 60 cents quarterly dividend was continued for the first three quarters of 1969. Total dividends paid in 1968 were $55.4 million while the Penn Central railroad lost $2.8 million ($41.9 million after the prior period's adjustments) and consolidated income of $87.8 million was reported. Total 1969 dividends were $43.4 million despite a deficit of $82.8 million ($91.6 million after extraordinary items) and a consolidated income of $4.4 million ($121.6 million loss after extraordinary items).

The Penn Central's management evidenced a rather cavalier attitude toward the declaration of dividends considering the company's financial straits. Declarations of quarterly dividends were based on overly optimistic earnings forecasts and the 1969 third quarter dividend was decided upon before the end of the second quarter. In the fourth quarter of 1969 losses were so great that the Penn Central was finally forced to stop paying dividends. Since dividends were

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[20] Adjusted to reflect the 1965 change in reporting.

[21] See for example Dr. Robert A. Nelson's verified statement set forth in Chapter II of "Specific Policy Recommendations and Argument in Support Thereof and Verified Statement of Facts and Conclusions of Robert A. Nelson" submitted on December 1, 1972 in Ex Parte 271 before the ICC on behalf of General Mills, Inc., American Paper Institute, American Retail Federation, and Certain-Teed Products Corp. In this piece Dr. Nelson among other things compares the outflow of capital funds (including dividend payouts) of railroads with air lines and motor carriers. The total funds generated less payouts (except dividends) by Class 1 trucking companies during the sample period (1956–1970) was $6.44 billion: $540 million of that was paid out in dividends. For the airlines the comparable figures (still using Dr. Nelson's materials) were $15.8 billion in funds generated and $819 million in dividends. For railroads the figures are $16.2 billion in funds generated and $6.0 billion in dividends.

greater than available cash resources the Penn Central had to borrow money to pay them. It is estimated that the interest costs on these loans were $66.7 million between 1963 and 1969 and $36.9 million in 1968 and 1969 alone. A higher interest cost could be imputed.

Penn Central management has argued that the dividends kept up the price of the stock and gave the railroad a better credit rating.[22] As long as the railroad paid dividends perhaps creditors would believe that the troubles of the railroad were only temporary. The stock price of the Penn Central reached a high of $86 in 1968 and was over $70 in 1969; however, the price started falling before the announcement that no dividend would be paid in the fourth quarter. The announcement caused considerable upset in financial circles but the Penn Central still borrowed $50 million in additional bank loans in early 1970.

Penn Central's management most certainly overestimated the importance of dividends to its standing in the financial community. Any favorable consideration it might have received as a result of its steady dividend payments could hardly have offset the cash drain of more than $130 million in dividends and

TABLE B-1

CAPITAL EXPENDITURES

PENNSYLVANIA AND NEW YORK CENTRAL; 1946–67 [1]

[In millions of dollars]

Year	Pennsylvania	New York Central	Year	Pennsylvania	New York Central
1967[2]	114.7	69.1	1956	92.4	79.3
1966	197.4	95.9	1955	69.0	39.6
1965	244.2	107.9	1954	41.0	39.1
1964	100.8	81.3	1953	80.5	88.0
1963	82.4	39.5	1952	123.3	148.4
1962	63.0	40.2	1951	215.6	125.7
1961	60.9	32.0	1950	87.8	70.6
1960	155.9	39.6	1949	105.8	100.5
1959	125.2	28.7	1948	106.3	90.2
1958	53.8	18.2	1947	52.7	48.4
1957	97.7	114.2	1946	33.7	41.2

[1] Includes leased lines.
[2] Excludes expenditures on leased equipment.

Source: ICC Form A, Railroad Annual Reports.

TABLE B-2

SUMMARY OF CAPITAL EXPENDITURES

PENNSYLVANIA, NEW YORK CENTRAL; 1948–67 [1]

[Millions of dollars]

Period	Road			Equipment			Total		
	Pennsylvania	New York Central	Total	Pennsylvania [2]	New York Central	Total	Pennsylvania	New York Central	Total
1948 to 1957	294.1	234.0	528.1	691.9	661.3	1,353.2	986.0	895.3	1,881.3
1958 to 1967	260.3	175.8	436.1	948.4	376.7	1,325.1	1,208.7	552.5	1,761.2
Total	554.4	409.8	964.2	1,640.3	1,038.0	2,678.3	2,194.7	1,447.8	3,642.5

[1] Includes leased lines.
[2] Excludes expenditures on leased equipment; 1967.

Source: ICC Form A, Railroad Annual Reports.

[22] For example, David Bevan responded in part to a question on dividend policy raised by ICC investigators as follows: ". . . all members of the Board recognized the intangible value of the long unbroken dividend record of the P.R.R. and that over a period of years it did add something to the way investment analysts regarded it from a quality standpoint. Therefore, there was a desire to maintain this unbroken record if feasible and in a number of years so-called token dividends of 25 cents per share were paid." Interstate Commerce Commission, Docket No. 35291, Verified Statement 40, Ex. INT–6; see letter from Edward C. German to George Deller, February 15, 1972; answer to question 1; Appendix D, Exhibit 53, p. 623.

related interest payments after the merger. In fact, well informed creditors might have given more favorable consideration to a railroad following conservative financial policy in times of operating difficulties. Penn Central's concern about maintaining the stock price is a curious anomaly since the stock offering was apparently never considered.

TABLE B-3.—TOTAL CAPITAL EXPENDITURES AS A PERCENTAGE OF OPERATING REVENUES, SELECTED RAILROADS; 1960-69

Year	Penn Central[1]	Pennsylvania	New York Central	Baltimore and Ohio	Chesapeake and Ohio	Southern
1969	9.17	----	----	5.96	7.65	26.15
1968	9.66	----	----	16.92	6.26	25.94
1967	9.42	8.22	10.07	7.85	25.46	19.68
1966	12.70	17.24	8.79	4.40	21.55	19.31
1965	15.28	20.17	10.79	7.74	8.97	12.12
1964	9.31	9.13	10.48	3.09	21.50	9.05
1963	2.99	2.56	3.85	3.93	17.61	12.93
1962	4.26	4.59	3.89	5.68	15.35	17.89
1961	4.57	4.94	4.69	2.11	3.81	5.58
1960	6.13	7.23	4.41	2.85	3.57	13.82

[1] Pro forma 1960–67.

Source: ICC form A, railroad annual reports.

TABLE B-4

CAPITAL STRUCTURE

PENNSYLVANIA AND NEW YORK CENTRAL; 1948–1967

Year	Pennsylvania					New York Central				
	Current liabilities plus long term debt (millions)	Long term debt (millions)	Equity (millions)	Current liabilities plus long term debt/equity (ratio)	Long term debt/equity (ratio)	Current liabilities plus long term debt (millions)	Long term debt (millions)	Equity (millions)	Current liabilities plus long term debt/equity (ratio)	Long term debt/equity (ratio)
1967	$930.9	$721.3	$1,255.6	0.74	0.57	$803.6	$665.9	$835.2	0.96	0.80
1966	858.6	688.4	1,422.2	.60	.48	792.6	658.3	980.4	.81	.67
1965	811.9	646.3	1,407.6	.58	.46	775.7	654.8	956.9	.81	.68
1964	736.3	562.7	1,402.6	.52	.40	765.4	633.3	938.2	.82	.68
1963	715.9	568.7	1,386.1	.52	.41	773.6	647.4	923.6	.84	.70
1962	752.1	609.9	1,385.4	.54	.44	794.4	674.0	926.0	.86	.73
1961	784.7	626.1	1,388.0	.57	.45	829.0	703.6	933.6	.89	.75
1960	777.8	630.7	1,392.9	.56	.45	821.9	714.6	956.5	.86	.75
1959	805.6	674.9	1,387.4	.58	.49	847.4	736.5	956.1	.89	.77
1958	822.3	692.5	1,385.6	.59	.50	877.6	767.5	962.9	.91	.80
1957	839.9	706.5	1,387.1	.61	.51	942.2	827.7	960.3	.98	.86
1956	874.8	724.1	1,392.7	.63	.52	938.8	813.7	972.6	.86	.84
1955	885.3	740.2	1,403.0	.63	.53	970.5	827.4	949.1	1.02	87
1954	889.4	768.4	1,392.5	.64	.55	947.4	822.7	909.9	1.04	.90
1953	950.4	810.2	1,362.8	.70	.59	968.5	834.8	933.1	1.04	.89
1952	977.8	830.6	1,343.9	.73	.62	953.9	819.8	904.3	1.05	91
1951	840.9	786.3	1,321.9	.71	.59	864.1	721.4	884.7	.98	.82
1950	863.5	707.2	1,305.0	.66	.54	826.5	675.0	872.5	.95	.77
1949	830.6	694.5	1,281.6	.65	.54	776.0	668.1	859.0	.90	.78
1948	869.8	676.3	1,277.8	.68	.53	757.7	632.1	848.9	.89	.74

Source: Moody's Transportation Manual.

TABLE B-5.—LONG TERM DEBT/EQUITY RATIO: PENNSYLVANIA, NEW YORK CENTRAL, AND CLASS I RAILROADS, 1948-67

Year	Pennsylvania	New York Central	Class I railroads	Year	Pennsylvania	New York Central	Class I railroads
1967	0.57	0.80	0.59	1959	0.49	0.77	0.58
1966	.48	.67	.57	1958	.50	.80	.59
1965	.46	.68	.56	1957	.51	.86	.58
1964	.40	.68	.55	1956	.52	.84	.59
1963	.41	.70	.54	1955	.53	.87	.59
1962	.44	.73	.55	1954	.55	.90	.69
1961	.45	.75	.56	1953	.59	.89	.50
1960	.45	.75	.57	1952	.62	.91	.63

Source: Moody's Transportation Manual.

TABLE B-6.—RATIO OF INCOME AVAILABLE FOR FIXED CHARGES TO FIXED CHARGES: PENNSYLVANIA AND NEW YORK CENTRAL, 1948-67

[Dollar amounts in millions]

Year	Pennsylvania			New York Central		
	Income available for fixed charges	Fixed charges	Ratio	Income available for fixed charges	Fixed charges	Ratio
1967	$37.2	$36.0	1.04	$62.9	$48.8	1.29
1966	85.6	35.5	2.41	89.8	44.7	2.01
1965	77.8	36.2	2.15	76.1	42.2	1.80
1964	61.7	34.6	1.78	69.5	40.4	1.72
1963	42.0	35.0	1.20	50.5	41.4	1.22
1962	33.0	36.9	.90	39.0	42.2	.92
1961	25.7	38.3	.67	46.4	42.9	1.08
1960	41.7	40.7	1.03	36.1	43.9	.82
1959	50.4	42.0	1.20	52.3	45.0	1.16
1958	49.3	45.2	1.09	49.0	45.4	1.08
1957	54.2	45.8	1.18	65.2	46.1	1.41
1956	84.1	45.0	1.87	88.8	47.2	1.88
1955	100.7	48.4	2.08	88.4	47.2	1.87
1954	56.5	47.3	1.19	68.0	49.4	1.38
1953	83.2	49.2	1.69	107.3	63.0	1.70
1952	73.0	48.2	1.51	106.6	62.5	1.71
1951	61.0	46.2	1.32	94.3	60.6	1.56
1950	61.9	43.6	1.42	108.0	62.8	1.72
1949	52.4	42.7	1.23	90.9	71.9	1.26
1948	57.3	42.6	1.35	113.0	72.2	1.57

Source: Moody's Transportation Manual.

TABLE B-7

EQUIPMENT FINANCING

PENN CENTRAL, PENNSYLVANIA, AND NEW YORK CENTRAL; 1958-69

[Dollar amounts in millions]

Year	Penn Central				Pennsylvania				New York Central			
	Equipment trust certificates issued	Net leased equipment expense	Net rent deficit	Ratio of leased equipment expense to net rent deficit (percent)	Equipment trust certificates issued	Net leased equipment expense	Net rent deficit	Ratio of leased equipment expense to net rent deficit (percent)	Equipment trust certificates issued	Net leased equipment expense	Net rent deficit	Ratio of leased equipment expense to net rent deficit (percent)
1969	0	32.9	183.8	17.9								
1968	0	27.1	169.3	16.0								
1967	21.7	24.6	144.0	17.1	0	18.9	88.1	21.3	21.7	5.8	56.0	10.3
1966	33.6	24.0	131.3	18.3	12.0	19.7	81.1	22.4	21.6	4.3	43.2	9.9
1965	25.6	30.6	126.9	24.1	10.4	25.1	84.9	29.6	15.2	5.5	42.0	13.1
1964	15.7	31.0	115.0	27.0	0	26.3	77.7	33.9	15.7	4.7	37.4	12.6
1963	7.9	28.4	111.8	25.4	0	23.9	74.2	32.2	7.9	4.5	37.5	11.9
1962	0	29.7	108.1	27.5	0	25.1	73.9	34.0	0	4.6	34.2	13.5
1961	8.0	29.6	95.5	31.0	0	25.7	64.8	39.6	8.0	3.9	30.7	12.8
1960	4.6	27.8	96.0	28.9	0	25.2	70.1	35.9	4.6	2.6	25.8	9.9
1959	0	15.3	82.3	18.6	0	12.6	61.6	20.5	0	2.7	20.7	13.2
1958	0	10.6	76.0	14.0	0	7.8	54.5	14.3	0	2.8	21.6	13.1

[1] Pro forma combination of Pennsylvania and New York Central; 1958-67.

Source: ICC Form A, Railroad Annual Reports.

TABLE B-8.—RAILROAD NET INCOME AND DIVIDEND PAYMENTS

PENN CENTRAL, PENNSYLVANIA, NEW YORK CENTRAL, AND CLASS I RAILROADS; 1952–70

[Dollar amounts in millions]

	Penn Central [1]			Pennsylvania			New York Central			Class I railroads		
	Railroad net income [2]	Dividends declared	Payout ratio of dividends to net income (percent)	Railroad net income [2]	Dividends declared	Payout ratio of dividends to net income (percent)	Railroad net income [2]	Dividends declared	Payout ratio of dividends to net income (percent)	Railroad net income [2]	Dividends declared [4]	Payout ratio of dividends to net income (percent) [5]
1970	($325.7)	0								$76	$439	578
1969	(82.8)	$43.4								464	487	105
1968	(2.8)	55.4								565	516	91
1967	15.3	55.1	360.1	$14.1	$33.5	237.6	$1.2	$21.6	1,800.0	322	537	167
1966	95.2	53.7	56.4	45.1	32.0	71.0	50.1	21.7	43.3	904	499	55
1965	75.4	[3] 45.4	60.2	33.9	[3] 27.7	81.7	[3] 41.5	17.7	42.7	815	471	58
1964	56.1	[3] 29.0	51.7	29.1	[3] 17.2	59.1	[3] 27.0	11.8	43.7	698	457	65
1963	16.2	[3] 10.1	62.3	9.2	[3] 6.8	73.9	[3] 7.0	3.3	47.1	652	379	58
1962	(7.0)	5.5		(3.2)	3.4		(3.8)	2.1		571	368	64
1961	(9.0)	3.3		3.5	3.3	94.3	(12.5)	0		382	358	94
1960	(6.8)	6.6		(7.8)	3.3		1.0	3.3	330.0	445	385	87
1959	15.7	4.9	31.2	7.3	3.3	45.2	8.4	1.6	19.1	578	403	78
1958	7.6	3.3	43.4	3.5	3.3	94.3	4.1	0	0	602	372	62
1957	27.5	34.2	124.4	19.8	16.5	86.4	8.4	17.7	210.7	737	427	50
1956	80.6	38.0	47.1	41.5	20.4	48.1	39.1	17.6	45.0	879	432	49
1955	93.5	32.8	35.1	41.2	19.8	47.6	52.3	13.0	24.9	928	447	48
1954	27.8	9.9	35.6	18.6	9.9	53.2	9.2	0	0	683	374	55
1953	71.0	26.2	36.9	38.9	19.8	53.5	34.0	6.4	18.8	924	382	41
1952	61.7	16.4	26.6	39.3	13.2	35.7	24.7	3.2	13.0	845	338	40

[1] Pro forma combination of Pennsylvania and New York Central; 1952–67.
[2] Excludes extraordinary items.
[3] Extra dividends.
[4] Figures rounded off to nearest million. Includes extraordinary items.
[5] Figures rounded off to nearest whole percent.

Source: ICC Transport Statistics and Moody's Transportation Manual.

TABLE B-9 CONSOLIDATED NET INCOME AND DIVIDEND PAYMENTS PENNSYLVANIA AND NEW YORK CENTRAL, 1952–67

	Pennsylvania			New York Central		
Year	Net income [1]	Dividends declared	Payout ratio of dividends of net income (percent)	Net income	Dividend declared	Payout ratio of dividends of net income (percent)
1967	60.3	33.5	55.56	11.0	21.6	196.36
1966	90.3	32.0	35.44	65.5	21.7	33.13
1965	70.1	[2] 27.7	39.51	52.4	[2] 17.7	33.77
1964	60.1	[2] 17.2	28.62	35.5	[2] 11.8	33.24
1963	31.8	[2] 6.8	21.38	13.8	[2] 3.3	23.91
1962	20.5	3.4	16.59	.2	2.1	1,050.00
1961	17.2	3.3	19.19	(10.3)	0	
1960	8.6	3.3	38.37	4.6	3.3	71.74
1959	16.7	3.3	19.76	13.2	1.6	12.12
1958	11.8	3.3	27.97	7.0	0	0
1957	29.4	16.5	56.12	12.2	17.7	145.08
1956	52.5	20.4	38.86	42.8	17.6	41.12
1955	50.2	19.8	39.44	57.1	13.0	22.77
1954	28.3	9.9	34.98	13.7	0	0
1953	47.3	19.8	41.86	44.8	6.4	14.29
1952	46.4	13.2	28.45	31.9	3.2	10.03

[1] Reported consolidated net income for the Pennsylvania RR. (1960–67) includes income of subsidiaries at least 50-percent owned by the PRR.
[2] Extra dividends.

Source: Moody's Transportation Manual.

TABLE B-10 DIVIDEND PAYMENTS PER SHARE[1] PENNSYLVANIA, NEW YORK CENTRAL, 1957-67

(1958-1967 average Pennsylvania $0.97; NYC $1.07)

Year	Pennsylvania	New York Central	Year	Pennsylvania	New York Central
1967	$2.40	$3.12	1962	$0.25	$0.33
1966	2.00	2.60	1961	.25	0
1965	2.30	2.60	1960	.25	.50
1964	1.25	.75	1959	.25	.25
1963	.50	.50	1958	.25	0

[1] Includes extra dividends.

Source: ICC form A, railroad annual reports.

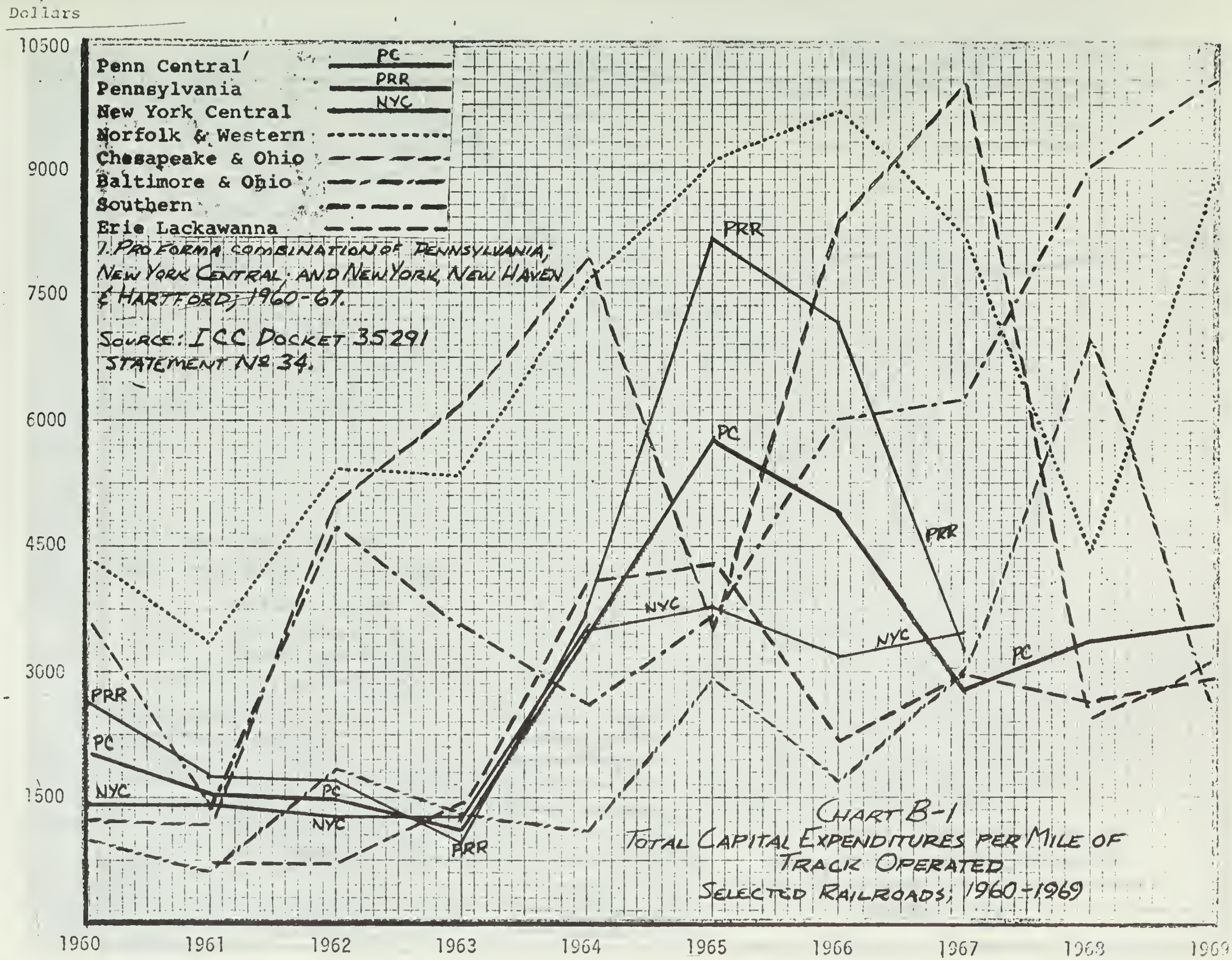

CHART B-1
TOTAL CAPITAL EXPENDITURES PER MILE OF TRACK OPERATED
SELECTED RAILROADS, 1960-1969

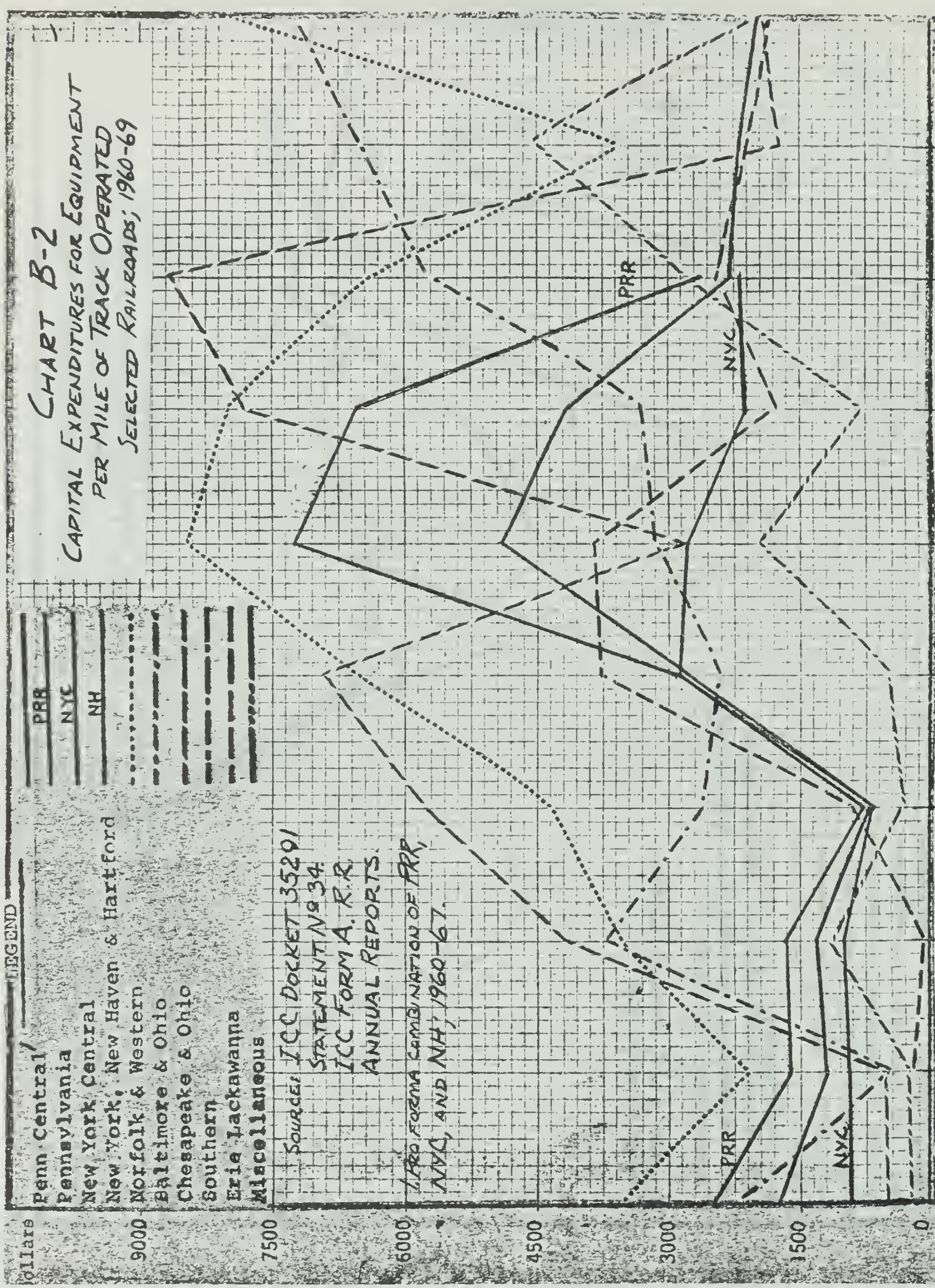
CHART B-2
CAPITAL EXPENDITURES FOR EQUIPMENT PER MILE OF TRACK OPERATED SELECTED RAILROADS; 1960-69
LEGEND
Penn Central 1/
Pennsylvania PRR
New York Central NYC
New York, New Haven & Hartford NH
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
Sources: I.C.C. Docket 35291 Statement No 34. ICC Form A, R.R. Annual Reports.
1/ Pro forma combination of PRR, NYC, and NH; 1960-67.
Dollars
9000
7500
6000
4500
3000
1500
0
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
PRR
NYC

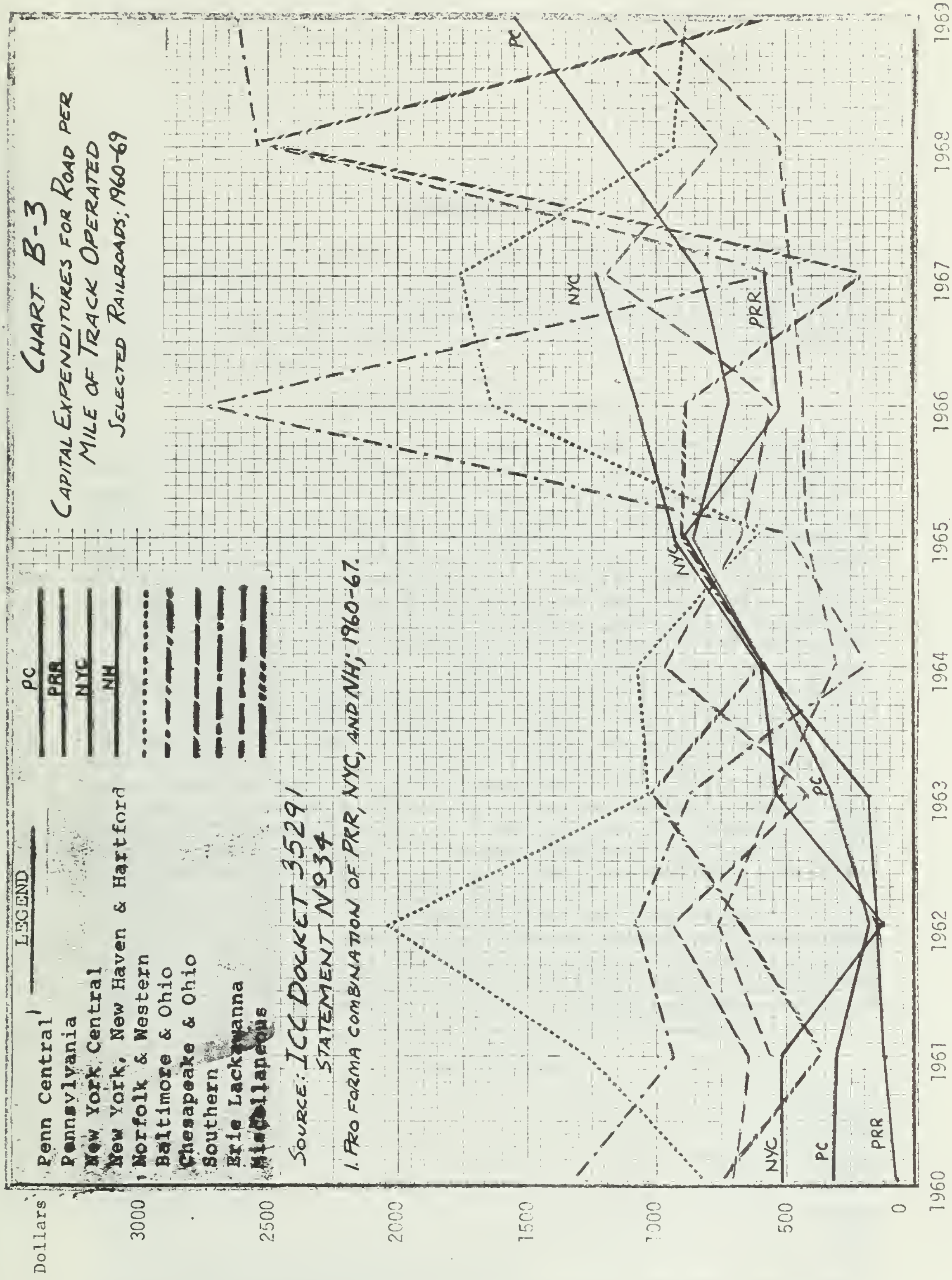
CHART B-3
CAPITAL EXPENDITURES FOR ROAD PER MILE OF TRACK OPERATED
SELECTED RAILROADS; 1960-69
LEGEND
Penn Central[1]
Pennsylvania
New York Central
New York, New Haven & Hartford
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
PC
PRR
NYC
NH
SOURCE: ICC DOCKET 35291
STATEMENT N934
1. PRO FORMA COMBINATION OF PRR, NYC, AND NH; 1960-67.
Dollars
3000
2500
2000
1500
1000
500
0
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
NYC
PC
PRR

DIVERSIFICATION

Diversification is an aspect of fiscal policy requiring special attention because it presumably set a basic management tone that permeated the Pennsylvania Railroad and the Penn Central (but not the New York Central) and virtually dominates public discussions of the bankruptcy. As with all elements of the case, this discussion endeavors as a minimum to put this policy manifestation in clear perspective.

THE DIVERSIFICATION FACTS

Diversification facts are largely undisputed and need be reviewed only briefly. The PRR traditionally enjoyed a broad economic base of outside investments, largely in the securities of other railroads and in land which constituted a major and stable source of earnings. The Central also enjoyed substantial external income, largely from development of its own property. It had only minor outside investments, and is unimportant for diversification considerations except for joint participation in the affairs of the Penn Central. This discussion focuses on the PRR's diversified investments after 1963 and their effects on the merged company, but with some intercompany comparisons.

Although all dimensions of the program are of interest, the cash involvement is particularly significant. Acquisitions totalled $320,313,000, including $203,203,000 in cash outlays. An additional $20.5 million was paid to the acquired companies in cash dividends and interest on securities granted in the purchase. The PRR made $172.1 million of the cash payments, the Central $21.4 million, and the Penn Central $16.1 million. Investment transfers contributed $69.5 million of the PRR commitment (from the sale of the N&W stock and of its interest in the Long Island railroad) and $33.2 million of the Penn Central's (from liquidation of N&W holdings). The balance was from working capital, including all of the Central's $24.4 million, $21.4 million coming in 1967 when its net income was only $1.2 million (compared with PRR's $15.6 million outflow and $14.1 million net income).

The net income sources of working capital have been detailed. (See also Table D–1). In summary, PRR suffered a loss from railroad operations totalling $20.4 million during 1964–67, but earned $148.5 million from other income, of which $64.1 million or about 44 percent came from the new investments. Central suffered operating losses of $7.6 million and earned outside income of $107.7 million, of which $3.3 million, or 3 percent, came from diversification.

ACQUISITIONS POST 1963[1]

Total investment (plus dividends)		$320, 313, 000
Cash (excluding dividends)		203, 203, 000
Dividend (cash)		20, 479, 659
Of which cash from—		
PRR (plus dividends)	$10, 924, 302	172, 069, 000
NYC		24, 437, 000
PRR	9, 555, 348	16, 134, 000
Transfer investment (millions):		
N. & W. and LI		(PRR) 69. 5
N. & W.		(PC) 33. 2

[1] Partial summary of findings. Detailed text appear at pp. 9–20 *infra*.

Note: Balance from "working capital" including all of NYC's $24,437,000 (versus $15,558,759 for PRR) and PRR net income in 1967 was $14,092,000 versus Central's $1,243,000.

SOURCES OF NET INCOME

[In thousands]

Year	PRR					NYC			
	Rail	Other old	Other new	Other total	Total	Rail	Other old	New	Total
1963	(12, 252)	21, 710			9, 158	(13, 834)	20, 873		7, 039
1964	(1, 190)	22, 766	7, 557		29, 133	(437)	27, 484		27, 047
1965	3, 349	19, 012	11, 536		33, 897	14, 112	27, 407		41, 519
1966	11, 799	13, 534	19, 722		45, 055	21, 672	27, 552	887	50, 111
1967	(34, 316)	23, 094	25, 314		14, 092	(32, 936)	31, 793	2, 377	1, 234
Total	(32, 610)	106, 116	64, 129	170, 245	137, 635	(47, 207)	107, 702	3, 264	84, 406

Diversification earnings totalled $65.6 million for PRR, $3.3 million for NYC, and $94.3 million for Penn Central.

Overall, the average annual cash return was $7.5 million against an investment of $138.4 million, or 5.5 per cent. Balancing cash investment, payments, and receipts, the deficit was $145.4 million. Crediting this flow with the proceeds of the N&W and Long Island liquidations as a substitute investment reduces this balance by $103.6 million to a net of $41.8 million. In these terms, the PRR suffered cash drains of $47.4 million and the Central $19.1 million, totalling $66.5 million. Penn Central showed a cash gain of $24.7 million, producing a final net outflow of $41.8 million.

RATIONALE

Virtually all PRR's substantial real estate holdings in major cities of its service area prior to 1964 were associated with the rail operation of the company and had been developed to enhance the revenues of the physical plant.[22] They contributed substantially through rental and capital gain income to the consolidated earnings of the railroad. The specific "diversification program" dates from late 1962 and early 1963.[23] The Pennsylvania then owned approximately 2.4 million shares of Norfolk and Western common stock, acquired over many years, with a total market value of approximately $300 million. These shares, a pawn in the approval of the N&W merger and hence of the PRR–NYC union, would have to be liquidated, shutting off a substantial source of dividend income. It was necessary to establish an income producing investment program from the proceeds of these shares.

Since these large holdings were lodged in the Pennsylvania Company, the liquidation had to be carefully handled to protect the subsidiary's credit standing because of its potentially vital role in upcoming refundings of transportation company debt in 1965 and 1968.

The investment of the liquidation proceeds in the railroad was explicitly considered, but was rejected because of its inability to produce savings from capital improvements. According to Bevan,

> * * * If the savings can be brought down to net in the future, then there is no need of acquiring these funds from the Pennsylvania Company and if not, there is no justification from a stockholder's point of view for doing it.[24]

On May 14, 1968, Chairman Saunders announced a new $500 million diversification program to run over six years, still aimed at finding a good substitute investment for the N&W holdings. The objective investment criteria were a minimum acceptable profit return, adequate growth, and the beneficial use of tax shelter.

Investment Pattern

The PRR's non-rail investments embraced three basic industries: (1) petroleum pipeline distribution; (2) real estate development; and (3) air transportation. Buckeye Pipeline was acquired in July 1964, primarily for efficient

[22] Because of the fact that ownership of such holdings was held in many subsidiaries, most of which were rail or rail-related operations, it would be nearly impossible at this date to segregate amounts expended on rail and non-rail activities in order to determine what the magnitude of total funds expended on the combined real estate holdings was, on either an annual or cumulative basis.

[23] The calculated acquisition of companies engaged in operations in product markets unrelated to that of the acquiring company, ostensibly for reasons of attaining economic stability, increasing earnings, etc.

[24] Memorandum by David C. Bevan, April 30, 1963, set out in full in text, infra, at p. 389.

railroad right-of-way utilization in a throwback to tradition.[25] However, at acquisition time, Buckeye was described by Saunders in a press release as "an important step in a long-range program of diversification." The emergence of this broader view of the acquisitions still tempered by the past is reflected in a May 1963, memorandum with the dictum that, "Logically, diversification should be into an industry which supplements or complements the basic operations and one which in concept and philosophy is readily understood by the management of the parent company." [26] Land use and transportation were the apparent common denominators.[27]

Another major criterion in investment selection was rate of return. The necessity of obtaining a high rate of return from any acquisition in order to replace the substantial 85 percent tax free cash dividend income from the N&W shares was stated as a dominant goal of fiscal management. However, this consideration played a relatively minor role in the Buckeye and (especially) in the real estate acquisitions.

Initial entry into real estate development was accomplished by the acquisition of controlling interest in Great Southwest Corporation (GSC) in June 1964. Called "an important step in a long-range program of diversification," by Saunders,[28] GSC was viewed as the nucleus of further diversification in real estate operations. It was subsequently employed in the acquisitions of Macco Realty Corp. and of I. C. Deal Corp.

Although a cogent rationale was not enunciated by the railroad, some reasons for acquiring GSC and entering real estate development were contained in an informal memorandum from the investment adviser to the railroad for its acquisitions, Glore Forgan, William R. Staats and Company. Among the reasons cited were: "* * * the experience of the railroad in industrial property management" combined with "* * * the stability and growth of GSC operations which could help overcome the cyclical character of the railroad business: and the opportunity to participate in the growth of an area which is expanding at a much faster rate than the operating territory of PRR." [29] The PRR press release on the acquisition also refers to the railroad's prior real estate "experience" but these reasons are not particularly compelling. The railroad owned and managed commercial property yielding rental income and had sold or leased parcels to shippers adjacent to the rail line. This experience is only distantly related to the industrial district projects of GSC which was the basis of the real estate activities of Arvida, Macco Realty, and later GSC.

GSC's "stability and growth" is also shallow in view of its short history marked by frequent losses. Even more basically, the real estate industry is highly volatile, dominated by fluctuating interest rates and the fortunes of local economies. Furthermore, the PRR's experience should have warned of the extraordinary financing demands normally made by such operations, with an endless need for external financing imposed by funds tied up in unsold properties for future development and a high rate of receivables, principally in the form of second trust notes. These absorb all funds generated internally and permit little in dividends. The principal reward is in capital gains realized from stock appreciation.

The investment in Executive Jet Aviation, Inc. (EJA), ostensibly an air taxi operator, was the vehicle through which the PRR hoped to enter a third area of business operations, air cargo transportation.[30] The railroad wanted to

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[25] No use of the railroads rights-of-way has been made for this purpose since acquisition of Buckeye.

[26] See Memorandum dated May 10, 1963 from Pennsylvania Railroad Finance Department, Appendix D, Exhibit 4, p. 494, for full text of this memorandum. Of course, the argument normally advanced in nearly all diversification programs, that of seeking to introduce earnings stability resulting from a wider earnings base (by acquiring companies whose operations are either subject to little or no cyclical pressures or whose business cycle is different from that of the parent company), was also present.

[27] There was a possibility of increased earnings of Buckeye through the pipeline movement of diesel fuel to railroad fueling points contiguous to the pipeline system (as well as reducing the railroad's own expenses in this regard). However, little of these possibilities appear to have been developed after acquisition.

[28] PRR press release dated July 24, 1964; see Appendix D, Exhibit 11, p. 516.

[29] Memorandum dated February 18, 1964, from WDS (Walter D. Scott) to CJH (Charles J. Hodge); see Appendix D, Exhibit 13, p. 518.

[30] EJA was also brought to the attention of the railroad by C. J. Hodge who later stated "I screened and proposed EJA. I thought any railroad management not aware of what's coming in air freight was not doing its job." ("End of a Bizarre Venture." *Bussiness Week*, August 16, 1969, pp. 122, 123). Moreover, both the Glore Forgan firm itself and several individual partners, including Hodge and S. A. Hartwell, who were both members of the EJA Board of Directors, possessed substantial equity holdings in EJA from the inception of the company.

become an integrated transportation company ("a transportation department store").[31] basically to counter competitive impacts in all areas and including certain bulk commodities that air freight threatened.[32]

The EJA investment was made despite Federal aviation laws effectively prohibiting control of transportation operations by a surface transportation company. The railroad attempted to avoid these "ownership" prohibitions, at least in form, by investing principally in debt securities. Legitimatizing this investment required a CAB determination that the ownership of non-voting securities did not constitute "ownership" or "control" of an air carrier or required a conclusion that ownership of EJA by the railroad was in the "public interest and to the public advantage" and not in restraint of competition. When EJA attempted to expand from its original air taxi activities, what might conceivably have permitted railroad ownership, to supplemental carrier status with nationwide passenger and cargo charter operations, the Civil Aeronautics Board ordered the railroad to dispose of its entire EJA investment.[33]

This investment (totalling $21.365 million) was sold by the railroad in January, 1972, for $900,000—a net loss of approximately $20.5 million. Besides the questionable legality of the investment, EJA was just commencing operations and needed large amounts of external financing in order to acquire the jet aircraft needed, most of which was provided by the railroad. There was little hope of an immediate or even near-term return on investment in either reportable earnings or, more certainly, in cash dividends. Like the real estate companies acquired, EJA was an extremely poor investment in light of the railroad needs.[34]

The Central's sole acquisition of Strick Corporation was not as much of an abrupt departure from rail activities into a totally unrelated product market. Strick, a manufacturer of lightweight aluminum trailers and vans and containerized equipment for the railroad industry, was a company whose operations had been known to the NYC since the advent of the latter's Flexi-Van service in 1956. The combination trailer-rail shipping container used by the NYC was manufactured by Strick and, for that matter, developed for this purpose. Moreover, the NYC was also a trailer customer of Strick for other parts of its rail-truck operations. Acquisition of Strick was therefore a partial integration of these operations, as well as an attempt to gain a greater return on investment. However, because of its own expansionary plans, Strick too became an unexpected drain (in terms of advances) on the cash resources of the railroad. Rath-

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[31] See list of "Reasons Why Transportation Diversification Should Benefit the Public," prepared by PCTC legal department, appearing as attachment to memorandum dated 3/10/69 by Basil Cole, Vice Pres., Administration. PCTC (and executive assistant to S. T. Saunders) to all PCTC department heads, with accompanying comments by certain railroad officials; Appendix D, Exhibit 27, p. 535. See also letter dated 1/23/67 from S. T. Saunders to Hon. Alan S. Boyd, Secretary U.S. Department of Transportation. Appendix D. Exhibit 29. p. 539.

[32] Remarks by S. T. Saunders to the New York Traffic Club on February 20, 1969 restates these reasons:

"Unless railroads are permitted to diversify into other forms of transportation, within a relatively short period of time air cargo will have the same effect on railroad freight traffic as passenger airlines have had on long-haul and intermediate range railroad passenger service since World War II.

"The impact of airborne freight could be the last straw for railroad freight services except certain bulk commodities, and railroads cannot survive on this sort of traffic alone. This imminent new threat underscores the need for the revision of laws and regulatory practices which prohibit railroads from ownership of other modes of transportation." Memo from Bill C to WAL, attached to March 10, 1969 memorandum of Basil Cole. Appendix D. Exhibit 28, p. 539.

[33] Executive Jet Aviation, Inc. Docket No. 17657 et al. Order No. 69–10–67 entered October 14, 1969. In addition, for its role in a series of illegal actions, including the pursuit of extensive foreign supplemental carrier acquisition activities resulting in actual control over several carriers (before obtaining requisite CAB approval), and the leasing of certain owned jet aircraft to these companies without disclosing such ownership interests to the CAB prior to receiving authority to lease the aircraft, the CAB levied a fine of $65,000 on the railroad (and $5,000 on EJA).

[34] The bizarre story of EJA and PRR (and later Penn Central) relationship has been chronicled in detail in numerous instances including Hearings before the Senate Commerce Committee, *Failing Railroad,* Part 2, serial No. 91–90, 91st Congress, 2d Session; a lengthy staff report of the U.S. House of Representatives Committee on Banking and Currency (The Penn Central Failure and the Role of Financial Institutions, Part II, "Case Study of Penn Central Subsidiary; Executive Jet Aviation," Staff Report of the Committee on Banking and Currency, dated December 21, 1970, U.S. House of Representatives, 91st Cong., 2d Sess.) and in numerous magazine and newspaper articles (e.g. see "Is the Sky the Limit for the Pennsy," *Business Week*, December 10, 1966: "End of a Bizzare Venture," *Business Week*. August 16, 1969, beginning at p. 122: "IAB: Aviations Big Whodunit," *American Aviation,* December 23, 1968 pp. 11–13: "CAB Studies Charge That Penn Central Sought Illegal Foothold in Air Transportation," *Wall Street Journal,* August 15, 1969: "Penn Central Told to Shed Control of Flying Service,' *Wall Street Journal,* October 16, 1969). It is not the purpose of this report to go into these details again other than to note in passing that the shoddy manner in which EJA was run by its top management gives testimony to the lack of PRR managerial guidance given to the operations of companies invested in (the special circumstances perhaps in existence here, that of trying to avoid the appearance of "control," not withstanding).

er than permit continued advances, at the expense of rail projects, many of which were being turned down, the Central cut off to further loans the first year after acquisition.[35] When Strick profits fell off the following year, and the merged railroad made financing arrangements to acquire trailers needed in its trucking operations at more economically advantageous terms than it could obtain by leasing them from Strick, the Strick company was sold.[36]

The merged company concentrated its initial diversification efforts on the acquisition of Kayser-Roth, the nation's leading apparel manufacturer. As an entry to the consumer goods field, this seemed to represent a vast improvement over the earlier acquisitions. The fundamental investment objectives restated by Saunders to the PCTC Board in connection with the consideration of the Kayser-Roth proposal reflected awareness of past difficulties; "* * * a company must be sufficiently large and established as a going concern * * *" (the three real estate development companies and EJA were all young companies with attendant financing demands and unstable earnings performances); "transportation companies * * * are not prime candidates because of potential conflict with certain anti-trust theories and regulatory policies * * *; "moreover, there are obvious advantages in using securities, rather than cash * * *").[37]

Had the other expressed objectives (profitability, growth potential, beneficial use of tax shelter) been employed with those set forth above, a more beneficial result from the diversification program of the PRR may well have emerged. Kayser-Roth appeared to represent a more reasonable approach to diversification in the sense of cash generation, than did prior diversification efforts. However, after approval by both companies' board of directors, but before submission to shareholders of the firms, Kayser-Roth officials terminated discussions in October, 1968.

The PCTC's investment (23 percent interest) in Madison Square Garden Corporation neither added to any established investment pattern (i.e. real estate operations) nor reflected any new departure. It represented primarily an opportunity for the railroad to exchange its stock interest in its Penn Terminal Co. (through which it owned Pennsylvania Station in New York City) for that in a more promising enterprise whose physical plant had been erected over the site of the railroad subsidiary's property. It is also noted, however, that the transaction represented an opportunity for the Transportation Company to record a $21 million gain on the exchange of stock.

The Central was appropriately wary of its proposed merger partner's real estate diversification activities as revealed in the minutes of the Board of Directors meeting in May, 1966, which considered a PRR request to raise its debt ceiling to cover these acquisitions. The Board expressed reservations about the wisdom of the PRR's entrance into the real estate development business but grudgingly consented to a raise to $195 million, nearly double the original $100 million ceiling.[38]

Considering its needs and objectives, real estate development was a peculiarly inappropriate choice for the railroad's diversification. While not offering the spectacular stock appreciation possibilities of real estate, many other channels could have provided the growth and return on investment objectives without the extraordinary financing demands or the accompanying sacrifice of cash dividends.

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[35] Beginning November 23, 1966 with a request for $1.1 million, seven more requests totalling $11 million were submitted to the railroad, $9.4 million of which was granted before it became apparent Strick was becoming much more of a cash drain than had been anticipated. On May 26, 1967, W. R. Grant, V. Pres. Finance, NYC wrote to Soi Katz, President of Strick, that such requests would no longer be granted by the railroad, because (a) worthy projects of the railroad were being turned down in the interest of conserving cash; (b) 2,000 people had been released from the Central's payroll; (c) Strick had given no indication that it was going to request more funds than in the original proposition to the railroad and (d) the railroad's cash had dropped $15 million in the past few months $9 million of which had been advanced to Strick. See Appendix D, Exhibit 30, p. 541.

[36] See letter dated May 6, 1969 (from A. E. Perlman to P. M. Shoemaker (Appendix D, Exhibit 31 (p. 544.)

[37] Acquisition of Kayser-Roth would have been accomplished by the issuance of approximately $231 million of two classes of Pennsylvania Co. cumulative preferred stocks, the only cash outflow to have been cash dividends paid on these shares ($1.05 million annually) to be, of course, offset by cash dividends received from the acquired company. (Memo used by S. T. Saunders, June 1968. Appendix D, Exhibit 7, p. 507.)

[38] Minutes—NYC Board of Directors meeting, May 4, 1966; Appendix D, Exhibit 14, p. 523.

Railroad Operations

Assessing the performance of the managements of the Pennsylvania Railroad and the New York Central Railroad in order to understand how it affected and was affected by the financial position of the companies is somewhat like the "chicken and egg" riddle. While it cannot be definitely answered, it can be profitably considered. In keeping with this study's pursuit of perspective, establishing even a rough balance will be useful.

A basic cornerstone of perspective is a clear assessment of the constraints conditioning management decisions; this is, indeed, the heart of putting responsibility in perspective. Constraints may be viewed here as they were in the fiscal policy treatment and classified roughly on the basis of how elastic or rigid they were and whether they were external or internal influences. Important elements of constraint include regulation, shipper relations, technological factors, competitive and market conditions, fiscal posture, merger gestation limitations, and connecting railroad relationships.

With fiscal policy separately treated, this assessment concentrates on management activities connected particularly with the operations of the railroads. The areas examined include plant and labor management, production management as reflected in equipment and plant utilization and the pricing and marketing of services.

The central purpose is evaluation rather than description. In some situations, evaluation is possible with absolute indicators; in others, a comparative approach is more meaningful. Comparisons of the merger partners are revealing because their approaches were sufficiently different to permit an evaluation of alternatives. Further comparisons with other railroads and of the Penn Central before and after bankruptcy offer insights regarding the company's condition.

The general setting of the evaluation is well known: The plant is run down, service levels are qualitatively impaired, physical indicators of performance efficiency are out of line, and costs are inflated. The purpose is to note specifics and search for reasons.

DECISION CONSTRAINTS

The major set of constraints may be considered as essentially environmental. The unfavorable market environment spells both financial stringency and a traffic volume which is usually either inching up painfully slowly or actually declining. The former restricts the tools available and the latter is a drag on efficient plant utilization and operating arrangements. The constraints in this class are somewhat internal and slightly elastic; that is, managements can assert some measure of control over market environment by "making a better mousetrap." But the opportunities are still limited if there is little interest in catching mice or if the mice still refuse to be caught.

Another regulatory constraint prominently mentioned as imposing a heavy drain on many railroads and as particularly significant for the Penn Central and its components is the restriction on the abandonment of unprofitable lines. Given the high fixed costs characteristics of railroads, traffic density is an important variable in profitability. Light density lines which are readily separable from profitable segments are thus prime candidates for elimination. A prominent result of the weakened market position of many railroads is a decline in density to unprofitable levels. It is asserted that about 80 percent of the Penn Central's freight revenues are attributable to just 11,000 of its 20,000 mile total.[39] Alternatively stated, nearly 50 percent of the mileage accounts for only 20 percent of the receipts. The inference is drawn that some of the remaining 9,000 miles are prime candidates for abandonment.

The profit impact of these relationships is, however, far from clear since it is much more difficult to determine the cost reduction that would be associated

[39] *Report of the Penn Central Trustees on Reorganization Planning, February 15, 1972.* Appendix D, Exhibit 54, p. 623.

with the 20 percent revenue decline from dropping the light density lines. The Penn Central is actively studying the matter, however, and tentative indications are that potential savings are not impressive in either absolute or relative terms.

According to an estimate in the Trustees' Report of February 15, 1972 the operation of the 11,000 mile core system envisioned would transform an actual 1970 operating deficit of $104 million to a $94 million gain, *given an 80 percent operating ratio.* But since the ratio achieved in 1970 for the 20,000 mile system exceeded 90, it is apparent that much of the gain cited is attributable to the much lower operating ratio which was postulated. Applying the 80 ratio to actual 1970 freight revenues of $1,392.4 million and reducing it by 20 percent produces a positive net of $222.8 million. This leaves only about $24 million as a saving attributable to cutting the plant virtually in half. This figure is reasonably consistent with an estimate of the Federal Railroad Administration of $60 million potential savings for all railroads in the country from justifiable plant reductions.[40]

It is likely that even $24 million is too high when a system-wide view is taken. Traffic which is unprofitable on a light density route may contribute to system net when account is taken of the lower unit costs on high density segments.

The latest "Interim Report" by the trustees exposes for public scrutiny a study indicating that because of labor protection costs, a system reduced to 15,000 would produce a higher Net Railroad Operating Income than would an 11,000 mile system.[41] Necessarily, numerous assumptions are made in the report making a thorough critical analysis of it impractical.

It may be assumed that the Penn Central has under its control certain track and roadbed which is not only uneconomic but provides no redeeming social, environmental, or other virtue and should therefore be abandoned. But deciding what should be abandoned requires close coordination within a railroad's management and demands careful attention to numerous factors including property taxation, changes in traffic routing, effects on pricing and marketing, and capacity of alternative facilities.

In some instances tax savings may play a dominant role in the decision to abandon. Because of peculiarities in Maryland's property tax laws, for example, a 1961 intercompany "personal" memorandum to the Pennsylvania Railroad noting that Maryland track "produces a savings of 2 to 4 times that obtained in any other state," concluded that "this statement vigorously demonstrates the need to eliminate as much track as is possible within the State of Maryland."[42] Tax savings for the Pennsylvania and the Penn Central were of great concern in every abandonment proposal.[43]

Various documents from the Penn Central files question the wisdom of certain management abandonment proposals. In October, 1970 the Marketing Department officials expressed dismay over several lines which had been added to the abandonment list, about which Marketing had not been consulted and which Marketing felt should be more carefully evaluated.[44] Another document dated June 3, 1970 suggested additional criteria which could have been employed in making up the abandonment plan.[45] The writer was concerned about increasing "circuity of mileage" because "invariably" circuitous movements undertaken as the result of abandonment "supposedly to reduce costs" actually "increase our costs and show up in the guise of lessened profitability, lessened incentive for investment, inability to quote competitive rates, etc." He was concerned that abandonments also affect leases, other contracts, and mortgages. In addition the relationship between total investment in a branch, its actual net salvage value,

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[40] Executive Briefing, Transportation Regulatory Modernization and Assistance Legislation, January, 1972, U.S. Department of Transportation; and Testimony by the Honorable John Volpe in hearings before Committee on Interstate and Foreign Commerce, House of Representatives, the Transportation Act of 1972, 92d Congress, 2d Session, Part 1 at page 148, Serial No. 92–76 .

[41] Trustees Interim Report of October 1, 1972, In re Penn Central Transportation Co., E.D. Pa., No. 70–347 ; Appendix D, Exhibit 55, p. 655.

[42] January 4, 1961 memorandum from J.P.N. to J.D.M. (J. D. Morris, in 1967 P.R.R. Vice-Pres. special services). Appendix D. Exhibit 56, p. 683.

[43] See for example file "073" from the Office of Vice President—Operation entitled "Tax savings to be derived from abandonment of all unnecessary tracks and/or facilities" reproduced in part in Appendix D, Exhibit 57, p. 683.

[44] October 13, 1970 memorandum from T. B. Graves to J. R. Sullivan (Asst. Vice-Pres. Marketing). Appendix D, Exhibit 58, p. 684.

[45] June 3, 1970 memorandum from George R. Wallace (Vice-Pres. Coal and Ore) to J. R. Sullivan. Appendix D, Exhibit 59, p. 684.

and its present or potential return should be weighed. Also of concern to the author was that actual expenses of the branch line should be subtracted from revenues it generated and the estimated contribution to the rest of the rail system should be carefully evaluated.

The difference in approach is evident. Some in management focus attention on cost reductions, others would emphasize an examination of future prospects for business. It may be questioned whether a massive abandonment program will necessarily provide the financial lift that is commonly thought to be so important. The Trustees' October 1 report gave currency to this question when it identified the unexpected impact on labor protection costs on a massive abandonment. It cannot be determined from the Trustees' October report the extent to which some of the other factors may have an unanticipated impact on costs. The Trustees' study assumes there would be sufficient traffic retained to ensure greater density, but apparently did not examine the very crucial question of impact on the main lines as compared to actual expense of the reduced traffic revenue generated by the branch lines. Nor does it seem to pay heed to possible extra costs of any circuitous routing which might be required where connecting links are severed. The Trustees have indicated that many factors must be given weight, including "practicalities of operation, future traffic potential and special characteristics of the various lines;"[46] they further indicate in the October 1 report their intention to plan for a 15,000 mile system.

Abandonment questions seem to be many and the projected benefits are not as clear as often stated. It is probably not justifiable therefore to place undue emphasis on the regulatory process as a restriction on line abandonment. Many other considerations are involved, not the least of which are sound business practices. Changing the ICC abandonment criteria may not yield the benefits claimed.

There are a host of other influences restricting management freedom, many of them peculiar to railroads. Rate regulation, a classic case, appears prominently in connection with the rail industry and individual railroad efforts to adjust prices. Relations with other companies in the industry are peculiarly limiting because of the physical interconnections and the joint production of services, leading to added complexities in the processes of revenue generation. Customers also exert a unique influence in rail transport markets; shippers are characteristically conservative, avowedly preferring rate stability to transport cost reductions. It is frequently difficult and risky for a carrier to contravene the desires and interests of large customers in matters in which he may have only an indirect interest. While this list could be expanded, it adequately demonstrates the broad range of forces impinging on railroad managements in the form of decision constraints. Management performance must be viewed in the light of these conditions.

PLANT INVESTMENT AND MAINTENANCE

As the earlier discussion indicated, the composite PRR–NYC put relatively small amounts of money into their plants in capital and maintenance as measured by other railroads, with a greater deficiency in the 1958–67 period than in the previous 10 years. The PRR consistently outspent its counterpart, both in maintenance and in capital investment and in roadway and equipment commitments. Its margin was even greater in the second than in the first 10-year period.

In terms of available resources, the capital expenditures of the two companies were mediocre but not disgraceful. Investment as a percent of operating revenues approximates the national average in recent years. During 1960–67, the PRR invested 9.26 percent and the NYC 7.12 percent (Table C–1). They exceeded the B & O (4.68 percent) but fell well behind the C & O (14.73 percent). PRR's relative commitment is even greater when combined maintenance and capital expenditures are related to net railway operating income (NROI). Over the years 1958–62, the Pennsylvania returned 11.62 percent of this net to its plant compared to the Central's 8.66 percent (Table C–3).

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[46] Penn Central Trustees' Plan for Reorganization, April 1, 1972. In re: Penn Central Transportation Co., (E.D. Pa.) No. 70–347; Appendix D, Exhibit 60, p. 686.

While the fiscal aspects of investment and maintenance programs are significant, it is necessary for present purposes to relate the outlays to physical and operating bases and to express the results in plant improvement terms.

A basic element of operating effectiveness closely geared to investment-maintenance expenditures is the supply of freight cars. The investment by both railroads as measured by freight car units in operation declined in the 20 years prior to the merger (Tables C–3, C–4). Between 1948–50 and 1964–66, tons of revenue freight fell 15 percent on the Central and 16 percent on the PRR. The number of freight cars dropped 38 percent and total tonnage capacity declined 33 percent for the NYC and 42 and 33 percent for the PRR. In the absence of a great improvement in freight car utilization, the ratio of cars and capacity to traffic volume was declining as reflected in net rents.

Both companies were net renters of equipment after World War II, but the Central's position deteriorated significantly after 1960 and the Pennsylvania's even more rapidly after 1957. Between 1948–50 and 1964–66 the NYC rent deficit increased 109 percent while the PRR figure leaped 367 percent. Although renting equipment saves capital expenditures in the short run and may offer flexibility in expenses during a recession, it is probably much more expensive in the long run and endangers service quality.

Meaningful interpretations and comparisons associated with investment and maintenance expenditures require that they be related to physical units. Generalizations regarding comparative performance are complicated by the wide annual fluctuations which characterize investment patterns, but some general relationships may be noted.

The Penn Central companies collectively invested in roadway an average of $684 per mile of track in 1960–69, marginally less than both the C&O and the B&O ($800; $826) and sharply below the Southern ($1,332) (Table C–5, Charts C–1, C–2). Starting out in the early 1960's at a very low level, they moved up to a reasonably representative position during the latter half of the decade. The performances of the separate companies were, however, mixed. Over the years 1960–67, PRR averaged $393 of road investment per mile of track but the Central reached an average of $690, both falling well behind the C&O ($761) and the Southern ($1,011).

The relative deficiency also holds for equipment investment (per mile of track), with a 1960–69 average of $2,346 for Penn Central, superior as usual to B&O but far below C&O ($4,079) and Southern ($3,742). Here again, the Penn Central performance was much better in the later years, largely because of PRR's programs. This company's 1960–67 average of $3,244 substantially exceeded the Central's $1,713 and compared favorably with Southern's $2,950.

Roadway maintenance requirements are functionally related to use as measured by gross ton miles. The Penn Central companies performed surprisingly well according to this test over the years 1958-70. They averaged $914, superior to C&O and B&O and only slightly below Southern's $945 (Table C–6). The Central ran ahead of its partner on this measure, with 1958–67 outlays per million gross ton miles averaging $908 to Pennsylvania's $855. The higher PRR absolute outlay was deflated by the introduction of the physical denominator to spell inadequacy relative to the Central.

Physical replacements expectedly reflect the monetary patterns. The composite level of tons of rail laid in replacement per mile of track operated and the cross tie replacement rate are low compared to the other roads (Charts C–5, C–6). The Central's volume predictably leads the Pennsylvania's, although the margin is small (Table C–9). PRR's rate of cross tie replacement fluctuated considerably over 1960–67 while Central's increased (Table C–9).

The low rate of physical replacement had unfavorable operating consequences including an increase in the rate of accidents. The PRR was plagued by slow order track which peaked in 1961 at about 360 miles but soared off the board at over twice that level in 1967 (Chart C–7). The accident rate increased throughout the East during the 1960's, advancing from 4.18 per million units in 1960 to 9.02 by 1967. The Central's rate also increased but was consistently below the regional level, rising from 3.3 to 7.0. The PRR rate rose from 5.5 to 14.4 (Table C–10 and Chart C–8). As a result of this behavior, the superior performance of the Central combined with the outlandish rate of the PRR pro-

duced a composite that was reasonably respectable in terms of the comparison roads.

Comparisons involving expenditures for freight car maintenance are complicated by the PRR's switch to rebuilding cars through subsidiaries and capitalizing the outlays and by the Central incorporation of the Pittsburgh & Lake Erie car fleet in 1964. The switch to capitalization understated maintenance expenditures, thus failing to reflect all of the resources devoted to the maintenance function. The P&LE incorporation increased the maintenance responsibility of the Central in absolute terms. While significant for some purposes, these discontinuities should not seriously influence comparisons of maintenance expenditures stated in unit terms.

While PRR's total 1958–67 expenditures for freight car maintenance exceeded Central's on the order of $340 million to $288 million, its per car average of $252 was far below its partner's $305, a figure comparing favorably with the other roads (Table C–7a). Pennsylvania's poor showing is further reflected in equipment condition. Even though its freight cars were utilized less intensively (car miles per car), its bad order ratio was consistently much higher than Central's which was also excessive (Table C–7b). A ratio of 5 percent is regarded as the maximum tolerable limit according to accepted industry standards. Central achieved a progressive reduction from 10.7 in 1960 to 6.0 in 1963 and on to 3.5 by 1967. PRR, by contrast, actually lived at around 15–16 until 1963 after which it managed to get down to 7.7 in 1965, only to climb back to 9.0 by 1967.

The PRR's total locomotive maintenance expenditure was also larger than Central's during the 1960's, reaching $458 million compared with $352 million, but the respective averages per unit were virtually identical at about $18,000 (Table C–8). Again, Pennsylvania's locomotives were utilized slightly less intensively than Central's in terms of annual mileage per unit with averages of 43,300 and 48,400 (1964–67). PRR's parity in average expenditure and lower utilization were linked with a higher unserviceable rate. The percentage of its fleet in unserviceable condition ranged from 15.4 to 18.5 in 1961–66 before settling back to 10.8 percent in 1967. Over the same period, Central's moved between 9.7 percent and 13.5 percent. In combination they exceeded the East, which dropped from 10.1 in 1961 to 7.2 by 1969. Penn Central started with 11.1 in 1968 and was able to get down to 7.9 in 1969 (Table C–8).

According to the data available for this summary, the Penn Central companies were fairly representative in terms of their plant maintenance and investment outlays relative to net railway operating income. They lagged further behind, however, in terms of commitments relative to physical plant units. As a result, their composite and merged plants were not adequately supported as manifested by unfavorable operating consequences.

In absolute amounts and in terms of available net income, the Pennsylvania outdid its partner in plant support, particularly with respect to equipment, its figures compared favorably with other roads. But it was not successful in producing results visible for these comparisons. In slighting roadway and favoring equipment, the Pennsylvania seems to have gotten the worst of both ends of the bargain. It gained no real payoff from the equipment commitment but suffered directly and severely from the roadway neglect. The operating consequences in unserviceable equipment and unsafe track hit with particular severity.

LABOR UTILIZATION

Available indicators point to relatively inefficient labor utilization by the two companies that got even further out of control after the merger. Since wage rates are largely standardized, high labor costs are a symptom of an unfavorable labor mix or inefficient utilization. These factors can be illuminated even though definitive causal judgments are elusive.

An initial hint of ineffective labor control is provided by the share of operating revenues accounted for by wages (Table C–11, Chart C–9). Although generally declining throughout the 1960's, the wage ratio remained high for both companies, ending up in 1967 at about 48 percent. Their performance was quite similar. They were able to match the C&O's record, but ran significantly

behind the B&O (and all Class I) and far behind the Southern. This unfavorable percentage suggests a relatively low productivity level that is confirmed by other indicators.

A significant measure of physical productivity is gross ton miles per employee (Table C–12, Chart C–10). While increasing along with the general industry trend, this indicator was very unfavorable, with both companies falling well behind the others. Here too they switched positions and observed no consistent differences. Over the three years 1965–67, the records were virtually identical, with an average of 2.170 million gross ton miles for the Central and 2.102 million for the PRR. On the other hand, the B&O–C&O combination averaged 2.693 million—roughly 26 percent higher (Table C–12). Essentially the same picture appears when productivity is measured in gross ton miles per service hour (Table C–13, Chart C–11).

The story alters slightly when wages are introduced, making the Penn Central picture even more dismal. While the monetary factor served as a brake on physical productivity advances, gross ton miles per dollar of compensation increased for all the companies except the C&O (Table C–14, Chart C–12). As would be expected, the Penn Central companies fell far below the others, with the PRR showing a slight superiority over the Central. But that margin, a 1965–67 average of 270 to 266 gross ton miles, was slight compared to the 28 per cent bulge of the C&O–B&O represented by a composite average of 343.

The hypothesis of wage costs increasing more rapidly for the PC companies than for the others is confirmed by the data depicting compensation per employee. Because of the identity in compensation patterns the companies are closely bunched and follow similar trends (Chart C–13). Penn Central pro forma) started the decade in a median position but wound up much the highest, parting company with the others with a sharp surge after 1967. Since wage rates are standardized, this behavior indicates an employee mix that is relatively expensive and becoming increasingly so.

Further insights regarding this phenomenon are supplied by the data for compensation per service hour (Table C–15, Chart C–14). Starting out again in a median position, this indicator for the PC companies generally moved upward along with the pack and managed to hold its position. The PC's superior performance for compensation per service hour over compensation per employee suggests that the unfavorable elements are associated with employees who were not operating trains.

Part of the explanation for the unfavorable showing of both the Penn Central companies is found in the relatively large number of employees per mile of track operated (Chart C–15). While following the general downward trend, the employment figure was well above the other companies' except in 1968 and 1969 when the C&O slid to the least favorable position. Notably, the PC improvement continued throughout even after the merger.

These data clearly confirm low labor productivity persisting over the recent past for both Penn Central companies. There is little to choose between them in this respect and they are far more like each other than like any of the other companies.

Financial results are significantly influenced by any leakage in wage accounts because of the overwhelming importance of this item, running around half of the revenue dollar. Furthermore, within the limits imposed by union contracts, wage costs are subject to rather close managerial control and can get out of hand without effective management vigilance.

A verified statement submitted for the ICC investigation attempts to measure the fiscal impact of the unfavorable wage and productivity factors.[47] The verified statement estimates the excess labor cost in 1969 at $377 million and even more in 1970.[48] The methodology employed is questionable, developing a *pro forma* Penn Central wage bill by substituting the Class I percentage of wages to revenues (45.1) for the actual Penn Central percentage (57) and applying the former to actual PC 1969 revenues. It is clear, in any case, that the wage bill is a real millstone, particularly considering the addition of fringe

[47] Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation Verified Statement 33.
[48] Id. p. 20.

benefits, estimated at about 15 percent of wage costs for railroads (an additional $57 million). Overtime penalties are also historically severe for the PC, as indicated in the following table.

Year	In thousands		Overtime as a percent of gross payroll	Number of employees (midmonth count)
	Gross payrolls	Overtime payments		
1961	$869,132	$56,484	6.5	131,850
1962	868,697	58,985	6.8	128,290
1963	847,300	65,935	7.8	121,593
1964	859,257	77,189	9.0	118,781
1965	885,338	83,594	9.4	115,845
1966	876,046	84,686	9.7	110,947
1967	876,763	85,996	9.8	106,150
1968	919,145	104,130	11.3	102,053
1969	941,674	109,346	11.6	97,679
1970	975,646	111,671	11.4	93,869

Source: ICC Docket No. 35291, V.S. 33, p. 22; 1961–1967 pro forma NYC, PRR, NH; 1969 & 1970 Penn Central Transportation Co.

While employment dropped from 132,000 to 93,869, advancing wage rates upped the payroll from $870 million to $976 million. Overtime payments rose even more rapidly, however, constituting 6.5 percent of the total in 1961 but 11.4 percent in 1970.

Regardless of their cause, these heavy wage payments represent a severe disability. They were undoubtedly inflated at merger time by the labor recall provided for in the premerger labor protection agreement, but the seriously unfavorable patterns were solidified well before then. But a real question is whether this huge disability is attributable to exogenous forces beyond management's control. Since wage rates are standardized, the cause is largely to be found in the high employment ratio (per gross ton mile) or in relatively high salaries of supervisory personnel. Excessive labor is an apparent concomitant of restricted capital investment. Another contributing factor is a relatively and absolutely high level of passenger traffic. But evidence of employment excesses is suggested by the sharp post bankruptcy declines and by prebankruptcy management statements about anticipated work force reductions it expected to accomplish. It appears that there was really inefficient labor utilization primarily attributable to inadequate management control.

PHYSICAL PERFORMANCE

Conventional railroad economic analysis evokes a set of "performance" or "efficiency" measures useful for inter-temporal and intercompany comparisons. While providing readings which reflect factors both within and beyond the control of management, these indicators are valuable tools if cautiously employed. It will be useful to see how the Penn Central companies stacked up in these terms. These readings are interpreted in the context of firms with generally debilitated plants and ineffectively controlled labor inputs.

The first set of measures concerns the extent to which plant and equipment are employed. A basic influencing factor focuses on the utilization of roadway to measure traffic density. This is expressed by the ratio of net ton miles per mile of road. This relationship is subject to managerial control only within the broad limits of traffic development and is more a function of market conditions than salesmanship (mousetrap requirements rather than mousetrap design). But since many costs are independent of volume, high traffic density has a very favorable income influence.

The PRR enjoyed higher densities than its companion and ranked in the middle of the comparison roads—above the B&O and E–L but below the N&W and C&O. The Central had lower traffic density than any of the comparison lines (Table C–16, Chart C–16). Density generally increased within the region until the 1966 reversal, continuing downward for the Penn Central but subsequently reviving for the others.

Efficiency is also furthered by favorable utilization of the rolling stock. Because of some stability in production functions relating rolling stock requirements to roadway, higher traffic density favors equipment utilization. But fac-

tors more subject to managerial control are also at work. Annual mileage per unit is favored by sound adjustment of equipment supply, expeditious movement, and minimum downtime. Despite its lower traffic density, the Central managed more locomotive miles per unit than its counterpart, although both fell behind the comparison roads (Table C–17, Chart C–17).

A useful measure of freight car utilization is car miles per freight car day. It is sensitive to car utilization, train speeds, shipper detention and yarding time and is thus substantially subject to management control. Because of the superior physical factors previously reviewed, the Central fared slightly better than the PRR in this dimension. Here again the Penn Central companies were sub par throughout and continued to lose ground. This combination gained 20 percent 1960–67 against approximately 40 percent for the C&O–B&O (Table C–18, Chart C–18).

The ratio of gross ton miles per freight train hour is a composite of various factors such as carloadings, train speeds, and train lengths. Because of the diversity of the underlying influence, it is a significant indicator. The PC partners were uncharacteristically respectable according to this test, being exceeded only by the C&O and N&W (Table C–19, Chart C–19). Both improved faster than the others during the upsurge of the 1960's.

The most inclusive set of measures embraces a wide range of the indicators cited to produce what approximates an "efficiency" guage expressed in net ton miles per freight car day. The anatomy of this inclusive indicator features a structure composed of the following elements: (1) car miles per serviceable freight car day (a function of turnaround), (2) the ratio of loaded car miles to total car miles, and (3) net ton-miles per loaded car mile. Stated otherwise, the amount of daily work performed by a freight car (representing a high fixed cost) is determined by the amount of its movement, the portion of its movement under load, and the extent to which it is loaded. The car mile (utilization) ratio for the merger pair is relatively low, but the Central's advantages over the Pennsylvania were eliminated by 1966 (Table C–18).

The ratio of loaded to total car miles is highly erratic, but the PC (pro forma) occupies a median position (Table C–20, Chart C–20). PRR's performance substantially exceeded the Central's, with respective 1961–67 averages of 61.5 percent and 57.3 percent. The average lading on loaded cars (net ton miles per loaded car mile) generally advanced for all the comparison roads and the PCC partners (Table C–21, Chart C–21). Again, however, the PRR showed consistent superiority as reflected in comparative 1961–67 averages of 40.0 and 37.8 tons.

The data reviewed now lead to the critical efficiency measure designated "net ton miles per freight car day." The performance of the PC team is expectedly poor, consistently falling behind both individually and as a composite (Table C–22, Chart C–22). They were well below the figures for the East and all Class I roads. Individually, the Central starts out slightly ahead of its partner but falls badly behind in later years despite a shot in the arm from the 1964 reporting consolidation of the P&LE.

This performance leads to a critical juncture in the analysis. The poor performance of the PC partners in this vital indicator is not surprising. But the comparative PRR–NYC performance contains a lesson. The Central racked up a number of factors of advantage, including the manifestations of plant condition (train speed) and car control (car miles per freight car day), but these forces were not strong enough to carry this inclusive indicator. It is instructive to review the comparative performances in the elements measured by the 1965–67 averages:

Indicator	Pennsylvania Railroad	New York Central
Car miles per serviceable freight car day	40.9	39.6
Percent loaded of total car miles	61.4	57.5
Average load per car	42.4	39.6
Net ton miles per freight car day	1,066	952

It is apparent that deficiencies in the average car loading and loaded car percentage outweighed any other advantage the Central had for purposes of

this indicator, a significant factor in the final assessment of management performance.

The true significance of these performance factors is their ultimate translation into monetary terms. They are most intimately reflected in the set of expenses linked to the "transportation ratio" which measures transportation expenses as a percentage of rail operating revenue. These expenses include the costs of operating, as distinguished from maintaining, the property. The largest single element is wages for operating trains as well as stations, signals, interlocks, and other property. The other major accounts cover locomotive fuel consumption and train supplies.

The Penn Central companies expectably produced higher ratios than their neighbors in terms of both the total and freight only expenses (Chart C–23). Consistent with the performance on "net ton miles per freight car day" but contrary to most previous indications in this analysis, the Pennsylvania maintained a consistently lower ratio than the Central. According to an intercompany comparison of accounts at intervals over the 12 years 1956–1967 summarized below, the ratios of wage elements to total transportation expenses are roughly equal, indicating that the differences arise primarily in the other expenses for train fuel, supplies and other expenses. While the transportation ratios are clearly a function of revenues as well as expenses, they are unquestionably significant for present comparative purposes.

[In percent]

	1956	1960	1964	1967
Total 8 largest accounts [1]:				
New York Central	71.6	70.8	69.4	68.4
Pennsylvania Railroad	68.1	67.3	65.9	64.4
Total of wage accounts only:				
New York Central	57.0	57.3	55.1	55.4
Pennsylvania Railroad	55.1	55.6	55.9	54.8

[1] Station employees, trainmen, yard conductors, and brakemen, train engine-men, train supplies and expenses, train fuel, yard enginemen, yard masters and yard clerks.

PRICING AND MARKETING

A review of transport pricing must carefully and explicitly consider the legacy of the past and the constraints of highly conservative contemporary institutions, all built on an extremely complex base. The system was designed to meet the commercial requirements and economic development goals of the country and of its several regions, along with the proprietary interests of the railroads. It was strongly demand oriented, with cost serving primarily as a rough test of competitive price relationships and of equitable treatment to localities, commodities, and shippers. This orientation, appropriate for the monopoly characteristics of rail transportation at the time, served the development goals and helped to encourage use of a generally under-utilized rail plant. It was also comfortable because it did not press into the problems of cost measurement in an industry characterized by the inability to assign costs to individual segments of business.

It is widely recognized that this structure has become less workable as economic conditions, transport requirements, and competitive relations have altered drastically in recent years. At the same time, a number of forces work against change that are far broader than the essentially conservative character of railroad management. Shippers themselves tend to favor the *status quo* umbilical cord, declaring their preference for stability (and even rigidity) over reductions in transport costs. Like the *ad valorem* tax assessor, the favored guide is last year's routines.

But aside from the institutional influences and behavioral proclivities, the problem of change is posed in particularly burdensome terms in the railroad case. Rates are literally formed into close knit and overlapping structures. No carrier or set of carriers controls a critical collection of the elements and a change in one collection inevitably has serious ramifications in others. How is massive reform engineered under these circumstances?

Even the tip of this iceberg clearly signals that the significant reform necessary to modernize railroad rate structures is a joint industry-government

problem that requires for meaningful consideration a considerable advance in concepts of public policy. Effectively addressing the problem is probably beyond the competence of an individual company. Evaluating management policy is essentially a question of how effectively available tools were employed.

One of the central issues addressed is the railroads' response to inflation, along with the treatment of associated competitive adjustments which will introduce matters of basic pricing philosophy including the role and use of costs. Response to inflation is particularly critical in a segment of the railroad industry, such as the Penn Central pair, suffering relative traffic stagnation since economies of increasing utilization are not available as a dampener. This review will keep an eye on management responsiveness and performance and philosophical sources of incompatibility between the two. Sharp differences in approach are characteristic.

The different policy approaches are epitomized by the positions of the two companies in the general rate level increase case of 1967. These general rate level or revenue cases pose unusually difficult and intractible issues, growing partly out of forces mentioned previously. Railroads, along with other industries, must at times and in some degree attempt to recoup the additional monetary costs imposed by inflation. To be effective revenue generators, rate increases must be broadly based which necessarily alters vital structural relationships. Proceeding on a commodity-by-commodity basis is time consuming and may be self-defeating from the carrier's short range viewpoint; over-generalizing intensifies the adverse structural effects and impairs the profitability of the increases by running afoul of adverse demand circumstances. Solutions must be worked out which are acceptable from a revenue standpoint while satisfying the requirements imposed by the ICC.

There is no clearcut answer to the questions posed. The railroads, the ICC and shippers have struggled with them throughout the years since World War II. The issues regarding structural relationships and revenue requirements posed in general rate cases are now the subject of a comprehensive investigation by the Commission.

The quite different approaches the PRR and the NYC took toward rates were rooted in contrasting philosophies and pricing approaches. It is noteworthy but not surprising that these general increases have extensively involved railroad top management not usually or heavily involved in the day to day rerate adjustments. Primarily for this reason approaches to rate-making have typically been even more divorced from technical competence than the other aspects of railroad pricing.

By the fall of 1966 there was strong support in the industry for applying to the ICC for a rate level increase. The Central's position was stated in a December 2nd meeting of the Eastern President's Traffic Conference. Its representation, headed by President Alfred Perlman, vigorously opposed an across-the-board increase, stressing the necessity for a restructuring of rates and selective decreases as well as increases where they would be profitable.

The PRR led the fight for the general approach and feared that the Central's opposition would cost the support of other companies both in the East and elsewhere and jeopardize an estimated $15 million revenue increase in 1967. Pennsylvania did not object to the merits of Central's view in principle, recognizing the economic superiority of that approach. But it feared that reaching industry agreement on the specific changes to be sought would delay presentation of the proposal to the ICC and its complexities would enhance the chances that the proposal would be suspended by the Commission on structural grounds. The general approach was considered tried and true, while Perlman was considered to have an unrealistic view of the type of revenue case that would have any prospect of prompt approval by the Commission. Perlman was adamant but was unable to generate a decisive following.

Although neither side held totally to its extreme position, effective compromise was elusive. The Central was willing to classify commodities into broad groups established to receive no change, modest increases, or larger advances, but PRR feared regulatory consequences even of this. On the other hand, PRR was willing to seek special treatment on selected commodities, but Central considered this inadequate. It was finally agreed that the Central

would go along with a modified general increase request with the understanding that the PRR and other railroads would support the rate restructuring program as a later separate proceeding.

The PRR's chief traffic officer justified its strategy with the explanation that it was not intended to actually impose the flat increase on all traffic. The uniform request was designed to facilitate prompt ICC approval after which actual increases could be selectively applied according to market dictates facing individual carriers.

The PRR did in fact, however, agree to some selectivity in the Ex Parte 256 application in deference to PRR Chairman Stuart T. Saunders' concern for relationships with the merger partner. While both sides compromised, the Central gained the least; the restructuring it desired was never effectively undertaken.

The division between the two companies reflected in the revenue case was a clear reflection of fundamental differences in general approaches to pricing problems and related matters of marketing. The Central under Perlman was a devotee of change, and pricing and marketing practices were in the forefront of this commitment. It had been led by tradition and by its newer precepts to emphasize profit concerns on a commodity-by-commodity basis, with a strong foundation of cost measurement and application underlying its pricing and marketing decisions. The cost measurement and underlying concepts were predicated on ICC formulas that have been subject to fierce criticism on a number of grounds. Despite this shaky foundation, the costs so derived were standardized, computerized, and ground out on a grand scale.

The PRR, on the other hand, had been sustained historically by its orientation to the steel industry and thus by highly profitable bulk commodities (represented primarily by coal) and steel products. It had traditionally given little emphasis to individual commodity profitability, but operated on the traditional economic thesis that having high fixed costs, railroads should be primarily concerned with increasing traffic volumes to reduce unit costs and thus assure profitability. In this context of all traffic making some contribution to fixed costs, it was logical to accept carloads as the Golden Grail.

This traditional view was being modified by the last half of the 1960's. In 1966, H. W. Large, Vice President in charge of traffic, instructed his newly formed Market Research Department to begin investigating costs on a disaggregated basis.

His interests and concerns were expressed along these lines:

> The two most serious problems confronting the Traffic Department and its marketing division today are accurate cost formulae to help in formulating pricing policies and to guide determinations for the acquisition of new equipment. I think you will agree with me that we are a long way today from achieving those two goals, as we are still largely dependent on system averages applied to specific commodities and movements.[49]

A related concern arose from indications of ICC requirements for more sophisticated cost support for rate applications.

The interest in sophisticated cost support for pricing and related decisions was actively pursued and resulted in the development by the Market Research Department of a comprehensive computerized management information system which included timely cost outputs.[50] It is described on its frontispiece as "a railroad management information system based on direct price/cost analysis of activity." Its accompanying inscription is lofty: "Business is Money. Business Management achieves in terms of money. The basic information for management must be in terms of Revenue/Expense/Net."

Its launching was, of course, handicapped and, aside from its merits and the climate of acceptance, there was little opportunity for the system to be influential before the bankruptcy. Unsatisfactory progress in developing an effective information system to supply cost data was recognized as a severe handicap after the merger. According to the top traffic official of the merged company:

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[49] Memo from H.W.L. to B.J.R. [Relyea] January 30, 1967; see Appendix D, Exhibit 61, p. 701.
[50] Penn Central Price/Cost Management Information System, April, 1968 (mimeo).

> There is no question about the shortcomings of our existing cost data. This is a severe handicap in making sound pricing and equipment investment decisions in the highly competitive transportation market. The M.I.S. has valuable added advantages in that the data produced through this system will provide operating personnel with accurate cost reactions to decisions in the field.[51]

Along with other information failures, this probably contributed substantially to the extreme postmerger managerial ineffectiveness.

Both the PRR and NYC approaches had merit. While from a private company viewpoint, rates which do not contribute more to cash inflow than they do to cash outflow are undesirable, change must be approached with caution for a number of reasons. Railroad costs are difficult to allocate to specific output categories in terms relevant for pricing decisions. Routine cost measurements such as those produced by NYC can easily cast a misleading aura of precision not conducive to sound decisions. While manifestly a powerful tool capable of facilitating greater cost measurement precision, computers also may only appear to circumvent the harsh realities of railroad cost behavior. Building on the average approach of the ICC cost formulations is particularly questionable.

As a further consideration, the true role of cost in pricing is still questionable. Given the largely indeterminate nature of railroad costs, market realities, and problems of plant utilization, a sensitivity to demand is required in the pricing process. In the view of many disinterested students, costs are best conceived as a pricing constraint establishing minimum and maximum levels.

Given the present state of regulatory processes, a highly selective approach to authorizations for rate adjustments responding to inflationary forces is not an unqualified best strategy. A substantial portion of the industry and many shippers concur in the PRR view that expedition and rough structural neutrality dictate a more generalized approach. The main procedural concern is regulatory authorization; there is some strategic advantage in achieving this as expeditiously as possible as a preface to effecting specific changes.

These considerations support the view that the PRR policies and approaches should not be judged in terms of the NYC as the normative standard. Differences in clientele and other circumstances and substantive complexities preclude this singular view.

A related matter was the marketing of services. As with pricing, the approaches were quite different. In keeping with its orientation to change, the Central had adopted approaches which were also commodity (product) oriented and reflected industrial marketing practices. They were explicitly designed to replace practices epitomized by the PRR and characteristic of virtually all other railroads. These practices were generally more customer and less analytically oriented. Differences in organizational arrangements may also be noted, the PRR marketing being a staff function but carrying line authority on NYC.

It is particularly important for present purposes to note that the differences were deep seated and considered critical by the participants, thus posing a primary source of incompatibility with severe postmerger implications. It is not clear that there is a neat black and white choice between right and wrong. Marketing must be related to the approaches that are appealing to the customers. Although change is under way, industrial traffic departments are still largely led by managers susceptible to traditional approaches, certainly having short run significance for traffic development. The propriety of commodity marketing approaches for a service industry is also a matter of question. While the Central's innovative practices are commendable and its marketing program embraced many features worthy of emulation, it does not necessarily follow that the adoption of a similar approach by the PRR and PC would have

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[51] Memo from H. W. Large to Mr. Saunders, November 14, 1969; see Appendix D, Exhibit 62, p. 701.

had a significant impact on events. Indications are rather that the merits of the two approaches are sufficiently mixed and other forces so strong that marketing innovation (at least to the extent it was employed by the Central) was not a critical determinent of the financial fate. It seems, rather, that a critical need for the Penn Central was a unified policy approach of either type to avoid the organizational paralysis that set in.

The complex range of variables controlling traffic volume, revenues, and profits preclude empirical investigation to effectively assess the respective fruitfulness of the alternative approaches to pricing and marketing. Gross revenue results can be examined, but they miss the critical element of profitability which was the touchstone of the Central's approach. But revenue performance was a virtual standoff during the early 1960's, with differences frequently explained by objective developments in the industries involved (automobile, steel, chemicals, etc.) rather than in the pricing and marketing policies of the two railroads. Over the years 1960–65 the Pennsylvania's gross freight revenues per car increased by 9.98 percent and the Central's by 8.55 percent. The Central's showing was helped particularly by a recovery of automobile traffic which is partly attributable to pricing/marketing activity; but the PRR's traffic increased by a higher percentage, an advantage which was minimized by the lesser importance of automobile traffic in its overall freight mixture.

PRR did better on vehicle parts and the Central better on iron and steel products. It is interesting that the PRR did relatively better in the 1960's comparisons after the launching of the Central's new look in pricing and marketing than in the longer sweep from the mid-1950's.

Another question involves the effectiveness of their combined strategies in maintaining their composite position with respect to their neighbors and competitors. Rough indications are provided by comparative trends in traffic volume, rates per ton, and revenues associated with 12 major commodities for the composite Penn Central and other Eastern carriers. (Charts C–23 to C–29.) [52]

Contrasting the patterns for 1965–67 and 1968–69 is interesting to differentiate the experiences of the companies before and after the merger. The revenue changes were relatively modest in each segment, particularly in terms of the changes in average revenue per ton, but some inter-period contrasts are notable. In the 1965–67 period, revenues moved downward in six cases, were rather stable in one, and increased in five. In the 1968–69 period, however, increases occurred in only two instances. The patterns for average revenue per ton diverged far more in the two periods. All cases showed a sharp increase in 1968–69 whereas 1965–67 was characterized by virtual stability (three cases) or rather slight increases. The postmerger is bleaker.

Intercompany comparisons reveal some major contrasts. The Penn Central's 1968–69 increases in average revenue per ton mile far outstripped those of the other carriers for eight of the commodities and were in the same range for the others. The associated tonnages expectedly were less favorable, falling distinctly behind the other performances in eight of the cases. These losses were partly recouped by the higher rates, however, since the revenue picture was relatively more favorable but still somewhat deficient.

This discussion of pricing and marketing identifies serious policy problems but hardly critical performance factors. Pricing and marketing strategy is a far longer range phenomena than would be decisive in the culmination of a financial crisis. Despite their differences of approach, the Pennsylvania-Central composite functioned reasonably well within the context of industry standards. What is really needed is a complete restructuring of rates with the introduction of new forms to meet current requirements. But this is an industry function that will require positive government participation (not negative regulation) to be achieved through new public policy concepts.

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[52] Including bituminous coal; primary metals; metallic ores; food and kindred products; chemicals; stone, glass and clay products; pulp, paper & applied products; field crops; lumber & wood products; motor vehicle parts & accessories; petroleum; motor vehicles.

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SERVICE QUALITY

The complete post-merger collapse in the quality of service provided railroad users was essentially the culmination of a steadily deteriorating ability of the individual companies to provide acceptable service compounded by consolidation problems.[53] This deterioration is partially reflected in traditional railroad "performance" measures but it can also be more directly viewed in terms of customer dissatisfaction.[54]

Clues of the first type are abundantly provided by the picture that has been drawn of management performance in connection with the railroad operations. In the most general terms, the productivity limitations noted may be expected to affect output quality as well as cost. According to one survey of shippers, the deterioration was apparent primarily in the unavailability of freight cars as needed and unreliable delivery schedules. The first is a function of car ownership, condition, and utilization and the latter of terminal operations.

The high bad order ratio which particularly plagued the PRR was compounded by a decline in utilization.

Average daily car movement on the Penn Central actually declined from 42 miles in 1968 to 38 in 1969, while other Eastern roads were maintaining levels ranging between 48 and 57 miles. And this low and falling utilization was combined with a 6 percent decline in the size of the freight car fleet. The upshot was freight car availability so low as to frequently jeopardize shippers' production schedules, sometimes even to the point of plant shutdowns necessitated by clogged inventory pipelines. The problems arising from car supply were made more acute by unreliable delivery performance which made it impossible for shippers to effectively plan for the receipt of raw materials.

The operating personnel of the railroad viewed the service problems as stemming from plant inadequacies. As previously explained, capital budgeting problems and the associated level of capital investment did result in inadequate car and locomotive fleets, obsolete yards, and poorly maintained roadbeds. But personnel problems, which peaked calamitously after the merger, also played a part. Performance was poor even in the modern yards. As an additional indication, car turnaround time was high even on available cars.

TABLE C-1.—CAPITAL EXPENDITURES AS A PERCENT OF OPERATING REVENUE, PENN CENTRAL, PENNSYLVANIA RR., AND NEW YORK CENTRAL RR., 1960–69

Year	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1969	9.17			5.96	7.65	26.15
1968	9.66			16.92	6.26	25.94
1967	9.42	8.22	10.07	7.85	25.46	19.68
1966	12.70	17.24	8.79	4.40	21.55	19.31
1965	15.28	20.17	10.79	7.74	8.97	12.12
1964	9.31	9.13	10.48	3.09	21.50	9.05
1963	2.99	2.56	3.85	3.93	17.61	12.93
1962	4.26	4.59	3.89	5.68	15.35	17.89
1961	4.57	4.94	4.69	2.11	3.81	5.58
1960	6.13	7.23	4.41	2.85	3.57	13.82

[1] Pro forma 1960–67.

Source: ICC Transport Statistics.

[53] The broader context of declining railroad service quality generally should also be noted.

[54] For more detail see ICC Proceedings Ex Parte 265 and Ex Parte 267, 339 ICC 136 through 156; study entitled "The Economy and the Railroads" in Part III of this report; and Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation, Verified Statement 15.

TABLE C-2.—RATIOS OF CUMULATIVE CAPITAL AND MAINTENANCE EXPENDITURES TO OPERATING REVENUES AND INCOME, PENNSYLVANIA RR. AND NEW YORK CENTRAL, 1958-67

	Maintenance expenditures to operating revenues	Capital investment to operating revenues	Total expenditures to operating revenues	Maintenance expenditures to NROI	Capital investment to NROI	Total capital expenditures to NROI
Pennsylvania RR	0.28	0.08	0.36	9.17	2.45	11.62
New York Central	.29	.06	.35	7.23	1.43	8.66

Source: ICC Transport Statistics and ICC railroad annual report, form A.

TABLE C-3.—CHANGE IN FREIGHT CAR FLEET, PENNSYLVANIA RR., 1948-67

Year	Freight cars added	Freight cars retired	Total at yearend	Aggregate capacity (thousands of tons)	Revenue freight tons (thousands)	Net rent deficit (thousands)
1967	4,419	9,649	112,431	7,646	175,758	88,082
1966	7,436	10,426	117,661	7,944	183,104	81,129
1965	10,974	9,821	120,651	7,780	177,251	84,924
1964	8,261	22,695	119,498	7,530	173,452	77,678
1963	9,308	15,911	133,932	8,262	164,267	74,245
1962	3,160	9,142	140,835	8,649	161,173	73,891
1961	4,333	13,939	146,817	8,935	152,876	64,783
1960	12,181	5,891	156,423	9,429	161,315	70,149
1959	13,755	37,156	150,133	8,990	163,870	61,566
1958	4,439	5,812	173,534	10,187	154,255	54,466
1957	5,037	2,474	174,907	10,251	199,960	39,135
1956	5,579	3,706	172,344	10,069	211,493	35,078
1955	5,165	20,244	170,471	9,940	201,431	36,222
1954	541	7,001	185,550	10,381	169,436	29,069
1953	3,526	5,242	192,010	11,221	206,196	24,763
1952	4,951	10,732	193,726	11,260	202,281	18,205
1951	15,012	10,516	199,507	11,524	225,086	22,706
1950	5,625	10,325	195,011	11,160	207,103	18,248
1949	1,979	23,121	199,738	11,320	184,537	19,811
1948	1,832	9,176	220,880	12,343	245,535	14,172

Source: ICC Transport Statistics.

TABLE C-4.—CHANGES IN FREIGHT CAR FLEET, NEW YORK CENTRAL, 1948-67

Year	Freight cars added	Freight cars retired	Total at yearend	Aggregate capacity (thousands of tons)	Revenue freight tons (thousands)	Net rent deficit (thousands)
1967	4,632	9,513	78,172	4,753	135,079	55,954
1966	5,732	7,252	83,053	4,964	139,454	43,191
1965	6,380	7,378	84,573	4,901	142,649	41,988
1964	4,582	7,502	85,571	5,012	140,054	37,354
1963	2,502	8,126	88,491	5,083	132,900	37,529
1962	4,106	10,940	94,115	5,382	128,968	34,242
1961	2,752	9,467	100,949	5,746	122,977	30,666
1960	2,124	5,075	107,664	6,088	133,361	25,811
1959	2,012	5,872	110,615	6,225	131,950	20,723
1958	468	5,306	114,475	6,419	126,385	21,575
1957	7,293	5,509	119,313	6,692	150,698	17,167
1956	5,250	7,101	117,529	6,558	166,102	21,562
1955	1,771	10,059	119,380	6,678	161,071	24,382
1954	1,535	16,170	127,668	7,139	141,245	23,593
1953	4,730	4,751	142,303	7,900	166,865	17,777
1952	7,017	3,334	142,324	7,856	164,041	13,155
1951	5,237	3,034	138,641	7,608	176,763	18,122
1950	3,274	4,426	136,444	7,445	165,835	20,748
1949	6,300	2,667	137,596	7,548	147,787	17,114
1948	6,262	3,003	133,963	7,234	184,730	21,135

Source: ICC Transport Statistics.

TABLE C-5.—CAPITAL EXPENDITURES PER MILE OF TRACK OPERATED SELECTED RAILROADS, 1960–69

[Dollars]

Year	Capital expenditures on road per mile of track operated						Capital expenditures on equipment per mile of track operated						Total capital expenditures per mile of track operated					
	Penn Central[1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern	Penn Central[1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern	Penn Central[1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
969	1,533			620	1,159	2,700	2,013			2,010	1,930	7,332	3,546			2,631	3,089	10,032
968	1,180			2,519	752	2,526	2,233			4,512	1,700	6,487	3,413			7,031	2,452	9,014
967	841	587	1,247	201	1,187	570	2,300	2,699	2,244	2,829	8,693	5,699	3,141	3,286	3,471	3,030	9,880	6,270
966	734	533	1,063	885	541	2,703	4,183	6,568	2,100	831	7,834	3,297	4,917	7,101	3,163	1,716	8,375	6,000
965	852	899	934	903	683	472	4,923	7,252	2,859	1,990	2,804	3,151	5,776	8,151	3,793	2,893	3,487	3,623
964	581	595	594	598	964	170	2,804	2,964	2,918	503	6,910	2,429	3,386	3,559	3,513	1,101	7,874	2,599
963	323	181	503	1,018	419	864	711	760	723	305	5,778	2,673	1,034	941	1,225	1,323	6,197	3,537
962	176	149	178	675	931	1,076	1,290	1,550	1,036	1,188	4,129	3,673	1,466	1,699	1,215	1,863	5,060	4,749
961	304	103	501	371	646	923	1,206	1,644	910	287	524	488	1,510	1,747	1,411	658	1,170	1,411
960	313	97	502	738	714	1,316	1,798	2,517	915	236	488	2,193	2,110	2,614	1,415	974	1,202	3,509
Total	6,837	3,144	5,522	8,528	7,996	13,320	23,461	25,954	13,705	14,691	40,790	37,422	30,299	29,098	19,206	23,220	48,786	50,744

[1] Pro forma combination of Pennsylvania, New York Central, and New York, New Haven & Hartford Railroads (1960-67).

Source: ICC form A, railroad annual reports.

TABLE C-6.—MAINTENANCE EXPENDITURES FOR WAY AND STRUCTURE PER MILLION GROSS TON MILES, SELECTED RAILROADS, 1958–67

	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	1198			956	807	1091
1969	989			910	873	990
1968	920			916	692	901
1967	830	846	801	814	652	760
1966	817	776	872	821	629	783
1965	811	801	823	764	616	922
1964	842	826	864	849	684	963
1963	871	803	965	890	728	899
1962	896	840	971	843	724	907
1961	882	865	904	951	750	942
1960	932	924	942	779	761	950
1959	925	910	945	840	733	976
1958	974	960	991	780	661	1198

[1] Pro forma combination of Pennsylvania, and New York Central; 1958–67.

Source: ICC Transport Statistics.

TABLE C-7A.—FREIGHT CAR-MAINTENANCE SELECTED RAILROADS; 1959–70

	Maintenance expenditures for freight-train cars (millions of dollars)						Freight-train car maintenance expenditures per car owned (dollars)					
	Penn Central	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	86.4			27.8	25.1	23.2	511			466	329	469
1969	70.7			23.8	22.2	20.4	404			381	287	425
1968	58.9			22.2	20.1	19.4	314			348	256	432
1967	55.3	31.3	23.9	19.4	18.5	16.5	290	279	306	305	227	423
1966	57.2	32.8	24.5	21.9	19.6	15.7	285	279	295	334	240	363
1965	56.7	31.1	25.7	20.9	18.0	15.1	276	257	303	302	214	352
1964	62.7	34.3	28.4	19.3	17.0	13.8	306	287	332	257	199	335
1963	62.7	35.1	27.7	23.3	16.1	14.1	282	262	313	322	184	357
1962	58.8	29.2	29.6	23.7	16.1	13.5	250	207	315	319	184	338
1961	59.4	27.8	31.6	24.5	15.9	13.5	240	189	313	277	179	337
1960	68.6	35.7	32.8	26.8	16.5	11.9	260	228	305	300	169	291
1959	80.7	43.8	36.9	27.8	15.9	13.6	309	292	333	292	163	323
1958	65.1	38.7	26.4	22.6	14.9	12.2	226	223	231	235	153	284

[1] Pro forma combination of Pennsylvania and New York Central; 1958–67.

Source: ICC Transport statistics.

TABLE C-7B.— FREIGHT-TRAIN CAR UTILIZATION AND BAD-ORDER RATIO

	Freight-train car-miles per car (thousands of miles)						Bad-order ratio [2] (percent)					
	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	20.1			19.2	15.4	19.8	6.2			3.8	2.3	6.5
1969	20.2			19.7	14.8	19.9	5.6			5.5	3.1	7.9
1968	18.9			18.4	15.3	19.0	6.3			5.9	3.9	6.8
1967	19.5	17.7	22.2	17.7	15.1	21.8	6.5	9.0	3.5	6.8	3.6	3.4
1966	18.7	17.5	20.6	17.5	15.6	19.6	6.4	8.6	3.8	5.0	4.1	3.0
1965	18.3	17.2	20.0	16.8	15.2	18.8	6.3	7.7	4.4	6.6	6.1	2.5
1964	17.8	17.3	18.6	15.0	14.2	19.4	7.4	8.4	6.0	7.5	4.9	3.0
1963	16.0	14.9	17.6	15.6	13.9	19.4	11.9	15.2	7.1	10.1	5.6	3.1
1962	15.3	14.3	17.0	13.9	12.9	18.9	12.8	16.2	7.7	14.9	5.4	3.1
1961	14.2	13.2	15.7	11.3	11.9	18.4	13.1	15.8	9.3	22.4	7.2	3.1
1960	14.2	12.9	16.1	12.4	11.5	17.0	12.7	14.1	10.7	18.9	6.6	3.7
1959	14.5	13.6	15.4	11.6	11.6	17.9	13.9	17.5	8.6	18.0	6.4	4.4
1958	12.9	11.8	14.5	11.3	12.1	16.8	12.2	15.9	7.2	16.0	3.6	4.8

[1] Pro forma combination of Pennsylvania and New York Central; 1958–1967.
[2] Percent unserviceable of total freight cars on line (average of 4 quarterly counts).

Source: ICC Transport Statistics, and AAR Operating and Traffic Statistics.

TABLE C-8.—SELECTED LOCOMOTIVE MAINTENANCE AND PERFORMANCE MEASURES—PENN CENTRAL, PENNSYLVANIA RR. AND NEW YORK CENTRAL, 1958-70

Year	Maintenance expenditures for locomotives (millions)			Maintenance expenditures per locomotive unit (thousands)			Mileage per locomotive unit (thousands) [2]			Percent unserviceable of locomotives assigned to freight service			
	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central	Eastern district
1970	100.5			24.1			42.7			8.9			7.1
1969	81.9			19.5			41.3			7.9			7.2
1968	71.4			13.3			33.5			11.1			8.7
1967	74.9	40.1	34.8	18.1	18.1	18.5	45.5	43.7	47.5	11.3	10.8	11.9	8.3
1966	76.7	42.6	34.1	17.8	18.0	17.6	46.0	44.3	48.1	13.2	16.1	9.7	8.2
1965	79.9	46.0	33.9	17.7	18.1	17.3	45.5	42.5	49.4	14.5	18.4	10.0	9.9
1964	79.6	44.3	35.3	17.7	17.6	17.8	45.2	42.7	48.4	13.7	16.2	10.6	9.
1963	76.8	42.4	34.4	16.7	16.4	17.1	20.7	20.8	20.7	14.9	15.4	13.5	10.0
1962	85.1	51.3	33.8	18.2	19.3	16.7	20.6	20.4	20.8	16.1	18.5	11.8	10.1
1961	81.8	47.2	34.6	17.0	17.2	16.8	19.8	19.1	20.7	15.4	16.8	12.5	10.9
1960	87.0	46.8	40.2	18.1	17.1	19.5	21.3	20.3	22.5	10.7	11.1	10.1	8.1
1959	89.2	51.3	37.9	18.5	18.8	18.1	21.5	21.1	22.1	11.0	11.0	10.7	8.7
1958	79.1	46.0	33.1	16.4	17.0	15.6	21.2	20.9	21.5	12.8	14.3	7.5	8.9
													0

[1] Pro forma, combination of Pennsylvania, and New York Central; 1958–67.
[2] Figures prior to 1964 indicate mileage per locomotives in train (number of locomotive units varies with the number of units attached to a train).

Source: ICC Transport Statistics; ICC form A, annual railway reports; AAR, OS series.

TABLE C-9.—MAINTENANCE OF PHYSICAL EMPLACEMENTS—PENN CENTRAL, PENNSYLVANIA RR., AND NEW YORK CENTRAL, 1960-69

Year	Rail replacement						Crosstie replacement					
	Tons laid (thousands)			Tons laid per mile of track operated			Crossties laid (thousands)			Crossties laid per mile of track operated		
	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central	Penn Central [1]	Pennsylvania	New York Central
1969	30.1			71			1,478.3			34.6		
1968	122.6			238			1,246.6			28.9		
1967	115.7	65.0	50.7	287	297	275	1,519.9	787.4	732.6	37.7	36.0	39.7
1966	75.5	29.1	46.4	186	132	249	1,362.8	658.3	704.5	33.5	39.9	37.8
1965	99.3	54.3	44.9	243	246	237	1,477.6	791.6	686.1	36.1	35.8	35.2
1964	89.3	49.6	39.7	215	221	207	1,399.2	737.6	661.6	33.7	32.9	34.6
1963	93.1	40.2	52.9	220	176	270	1,207.9	599.4	608.5	28.5	26.3	31.1
1962	111.1	50.6	60.6	262	220	304	1,354.2	741.1	613.1	31.6	32.3	30.8
1961	71.5	32.4	39.1	164	140	192	917.6	525.1	392.5	21.1	22.6	19.3
1960	98.1	47.3	50.8	211	203	242	1,297.7	760.2	537.5	29.3	32.6	25.6

[1] Pro forma combination of Pennsylvania, and New York Central; 1960–67.

Source: ICC Transport Statistics.

TABLE C-10.—RAILROAD ACCIDENTS PER MILLION UNITS, SELECTED RAILROADS; 1960–69

Year	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1969	12.6			8.0	9.2	7.2
1968	12.1			6.5	9.7	8.5
1967	10.8	14.4	7.0	5.6	9.4	11.5
1966	9.2	12.5	5.5	6.0	7.0	12.0
1965	7.9	10.5	5.0	6.0	7.4	9.6
1964	5.5	7.8	3.7	7.6	6.3	8.6
1963	5.1	6.9	3.8	5.6	6.1	6.8
1962	5.0	6.9	3.7	5.0	4.1	6.8
1961	5.0	7.0	3.2	4.2	3.9	5.2
1960	4.4	5.9	3.3	3.8	3.0	4.6

[1] Pro forma combination of Pennsylvania, and New York Central; 1960–67.

Source: ICC docket No. 35291, U.S. 34.

TABLE C-11.—WAGES AS A PERCENTAGE OF GROSS OPERATING REVENUE, SELECTED RAILROADS; 1960–69

Year	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	55.8			40.3	47.1	(2)
1969	51.3			38.9	48.0	31.9
1968	49.1			40.3	47.5	32.1
1967	47.8	47.7	48.0	41.0	45.3	32.9
1966	46.5	46.9	46.0	41.2	44.1	38.2
1965	48.0	49.0	46.8	42.5	42.7	39.3
1964	48.9	50.3	46.9	42.8	44.4	38.9
1963	49.5	49.6	49.5	43.3	44.1	35.8
1962	51.9	50.3	54.0	46.0	46.1	37.9
1961	53.9	51.4	55.6	51.2	47.1	39.0
1960	53.7	52.6	55.0	50.1	45.1	38.5

1 Pro forma combination of Pennsylvania, and New York Central; 1960–67.
2 Not Stated.

Source: Moody's Transportation Manual.

TABLE C-12.—GROSS TON-MILES PER EMPLOYEE [1] SELECTED RAILROADS; 1960–70

[Thousands]

Year	Penn Central [2]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	2,118.2			2,990.7	2,727.6	3,453.4
1969	2,109.5			2,967.7	2,549.6	3,467.9
1968	2,079.3			2,776.8	2,579.4	3,198.7
1967	2,100.8	2,163.4	2,265.4	2,629.3	2,722.4	3,140.0
1966	2,064.0	2,136.4	2,187.2	2,549.6	2,849.4	3,019.1
1965	1,945.5	2,008.1	2,058.7	2,506.0	2,902.5	2,625.0
1964	1,825.8	1,952.0	1,834.4	2,288.5	2,731.9	2,481.9
1963	1,723.7	1,885.3	1,738.1	2,115.7	2,642.9	2,063.8
1962	1,628.2	1,726.3	1,645.8	1,913.7	2,409.1	2,005.3
1961	1,520.1	1,596.7	1,563.9	1,782.6	2,287.6	1,882.1
1960	1,442.8	1,462.7	1,532.1	1,733.5	2,326.5	1,793.1

1 Gross ton-miles of cars, contents and cabooses (freight and passenger.)
2 Pro forma combination of Pennsylvania; New York Central; and New York, New Haven & Hartford; 1960–67.

Source: AAR, OS series; and ICC forms A & B, railroad annual reports.

TABLE C-13.—GROSS TON-MILES PER SERVICE-HOUR, SELECTED RAILROADS; 1960–70

Year	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	852			1,286	1,232	1,509
1969	853			1,277	1,139	1,487
1968	840			1,182	1,110	1,370
1967	874	905	941	1,133	1,147	1,361
1966	843	893	871	1,082	1,155	1,284
1965	795	839	818	1,072	1,147	1,105
1964	746	809	741	966	1,043	1,058
1963	712	779	706	919	1,019	885
1962	683	739	678	843	943	879
1961	642	684	652	784	910	843
1960	616	646	633	763	926	800

1 Pro forma combination of Pennsylvania; New York Central; and New York, New Haven & Hartford; 1960–70.

Source: ICC transport statistics.

TABLE C-14.—GROSS TON-MILES PER DOLLAR OF COMPENSATION, SELECTED RAILROADS; 1960–70

Year	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	204			319	291	355
1969	219			333	286	368
1968	231			332	310	361
1967	254	267	267	345	332	377
1966	261	275	269	332	351	384
1965	254	267	261	337	353	344
1964	252	269	254	332	350	353
1963	247	270	245	319	354	298
1962	240	259	239	297	333	302
1961	231	245	234	285	328	297
1960	227	236	233	282	342	289

1 Pro forma combination of Pennsylvania; New York Central; and New York, New Haven & Hartford; 1960–70.

Source: ICC transport statistics, and ICC wage statistics.

TABLE C-15.—COMPENSATION PER SERVICE-HOUR, SELECTED RAILROADS; 1960–70

[Dollars]

Year	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	4.18			4.03	4.23	4.25
1969	3.90			3.83	3.99	4.04
1968	3.66			3.56	3.58	3.79
1967	3.43	3.40	3.52	3.28	3.45	3.61
1966	3.23	3.24	3.24	3.26	3.29	3.34
1965	3.12	3.14	3.14	3.17	3.16	3.21
1964	2.96	3.01	2.91	2.91	2.98	3.00
1963	2.88	2.88	2.89	2.88	2.88	2.97
1962	2.85	2.86	2.84	2.84	2.84	2.91
1961	2.78	2.80	2.78	2.75	2.77	2.84
1960	2.72	2.73	2.71	2.70	2.71	2.77

[1] Pro forma combination of Pennsylvania, New York Central and New York, New Haven & Hartford, 1960–67.

Source: ICC transport statistics, ICC wage statistics.

TABLE C-16.—NET TON-MILES OF REVENUE FREIGHT TRAFFIC PER MILE OF ROAD OPERATED, SELECTED RAILROADS, 1960–69

[Millions of ton-miles]

Year	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Norfolk & Western	Erie Lackawanna
1969	4.33			5.22	6.70	7.02	5.36
1968	4.38			5.10	6.75	6.80	5.15
1967	4.48	5.40	4.04	4.88	6.90	6.55	4.86
1966	4.50	5.63	4.00	4.94	7.00	6.64	4.94
1965	4.40	5.40	3.84	4.64	7.00	6.41	4.64
1964	4.10	5.05	3.48	4.28	6.62	6.00	4.28
1963	3.90	4.86	3.30	3.86	6.49	([2])	3.86
1962	3.74	4.66	3.18	3.94	5.86	([2])	3.94
1961	3.52	4.35	3.06	3.63	5.38	([2])	3.62
1960	3.55	4.34	3.12	3.62	5.72	([2])	3.60

[1] Pro forma combination of Pennsylvania; New York Central; New York, New Haven & Hartford; 1960–67.
[2] Not available prior to 1964.

Source: Estimated from ICC, Docket No. 35291, V.S. 34, chart E-8

TABLE C-17.—MILEAGE PER LOCOMOTIVE UNIT, SELECTED RAILROADS, 1964–70

[Thousands of miles

Year	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	42.7			54.2	50.5	76.9
1969	41.3			55.2	53.0	69.6
1968	41.1			57.7	53.3	74.8
1967	45.5	43.7	47.5	54.8	51.5	68.0
1966	46.0	44.3	48.1	57.7	54.7	70.1
1965	45.5	42.5	49.4	53.6	54.5	65.9
1964	45.2	47.2	48.4	50.1	52.5	68.4

[1] Total locomotive unit-miles for freight trains per locomotive units at close of year. Figures not available prior to 1964.
[2] Pro forma combination of Pennsylvania and New York Central; 1964–67.

Source: ICC transport statistics.

TABLE C-18.—CAR-MILES PER SERVICEABLE FREIGHT CAR-DAY, SELECTED RAILROADS, 1958–70

Year	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	40.9			50.2	44.2	56.5
1969	39.4			57.9	44.6	61.6
1968	39.3			57.3	44.7	52.5
1967	40.3	40.8	40.1	52.2	46.0	42.8
1966	40.0	42.0	37.3	49.7	50.4	41.9
1965	40.4	40.0	41.3	50.5	46.5	39.2
1964	40.2	40.0	41.7	42.5	42.6	44.0
1963	36.7	36.3	38.6	41.8	43.4	43.0
1962	36.7	35.8	39.0	38.0	39.7	42.4
1961	36.1	33.9	37.8	37.4	36.5	40.8
1960	36.7	33.7	39.2	38.5	35.6	39.9
1959	35.5	34.4	37.7	37.3	36.7	43.8
1958	33.8	33.5	34.0	34.7	35.4	43.1

[1] Pro forma combination of Pennsylvania and New York Central; 1958–67.

Source: A.A.R., O.S. series.

TABLE C-19.—GROSS TON-MILES[1] PER FREIGHT TRAIN-HOUR, SELECTED RAILROADS, 1958–70

Year	Penn Central[2]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	72,376			76,307	82,886	69,002
1969	68,883			76,194	77,522	67,169
1968	72,281			66,024	83,489	65,230
1967	73,644	71,550	76,557	63,913	76,452	66,859
1966	71,222	69,441	73,795	63,457	74,348	63,794
1965	67,657	66,176	69,761	66,131	75,383	57,453
1964	64,912	64,196	65,959	65,424	79,954	60,325
1963	63,336	63,790	62,716	64,656	76,320	59,604
1962	62,112	62,413	61,647	63,956	73,576	61,220
1961	59,380	58,858	60,056	57,865	72,024	59,490
1960	57,960	56,134	59,458	56,849	71,546	56,225
1959	56,190	55,770	57,159	55,243	75,882	58,410
1958	54,903	55,967	53,554	54,751	78,052	53,844

[1] Gross ton-miles of cars, contents, and cabooses (freight only).
[2] Pro forma combination of Pennsylvania and New York Central; 1958–67.

Source: A.A.R., O.S. series.

TABLE C-20.—PERCENT LOADED OF TOTAL FREIGHT CAR-MILES, SELECTED RAILROADS; 1958–70

Year	Penn Central[1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	58.2			57.9	53.8	58.5
1969	58.8			58.3	54.1	60.1
1968	58.7			58.6	54.7	59.8
1967	58.9	60.6	57.0	58.6	53.3	58.3
1966	60.1	61.9	58.0	59.7	54.2	59.5
1965	59.8	61.6	57.6	58.9	54.9	60.7
1964	59.6	61.3	57.4	57.5	54.3	60.3
1963	59.9	61.8	57.6	58.0	54.2	59.0
1962	59.6	61.8	56.9	58.7	54.1	60.6
1961	59.1	61.3	56.6	58.1	54.4	61.8
1960	59.1	61.2	56.7	58.4	55.2	62.3
1959	60.4	62.6	57.8	59.4	55.3	64.2
1958	58.9	61.0	56.2	59.7	54.7	62.5

[1] Figures for Penn Central are pro forma prior to 1968.

Source: AAR, O.S. series.

TABLE C-21.—NET TON-MILES PER LOADED CAR-MILE, SELECTED RAILROADS; 1958–70

Year	Penn Central[1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	43.5			44.8	60.2	46.7
1969	43.3			43.9	57.7	45.2
1968	42.6			45.6	56.0	44.3
1967	41.1	43.0	40.0	44.4	53.7	43.0
1966	41.0	42.8	39.9	44.7	51.2	43.1
1965	39.9	41.5	39.0	44.5	50.3	42.2
1964	38.7	40.3	37.9	43.9	50.4	39.4
1963	37.4	38.6	37.1	41.8	50.6	37.9
1962	36.4	37.5	35.6	40.8	49.2	36.1
1961	35.5	36.4	35.1	41.2	48.0	34.8
1960	34.1	35.8	33.9	39.6	48.8	33.1
1959	33.5	34.4	33.2	38.2	49.0	32.5
1958	33.3	34.2	32.9	37.2	49.6	31.9

[1] Figures for Penn Central are pro forma prior to 1968.

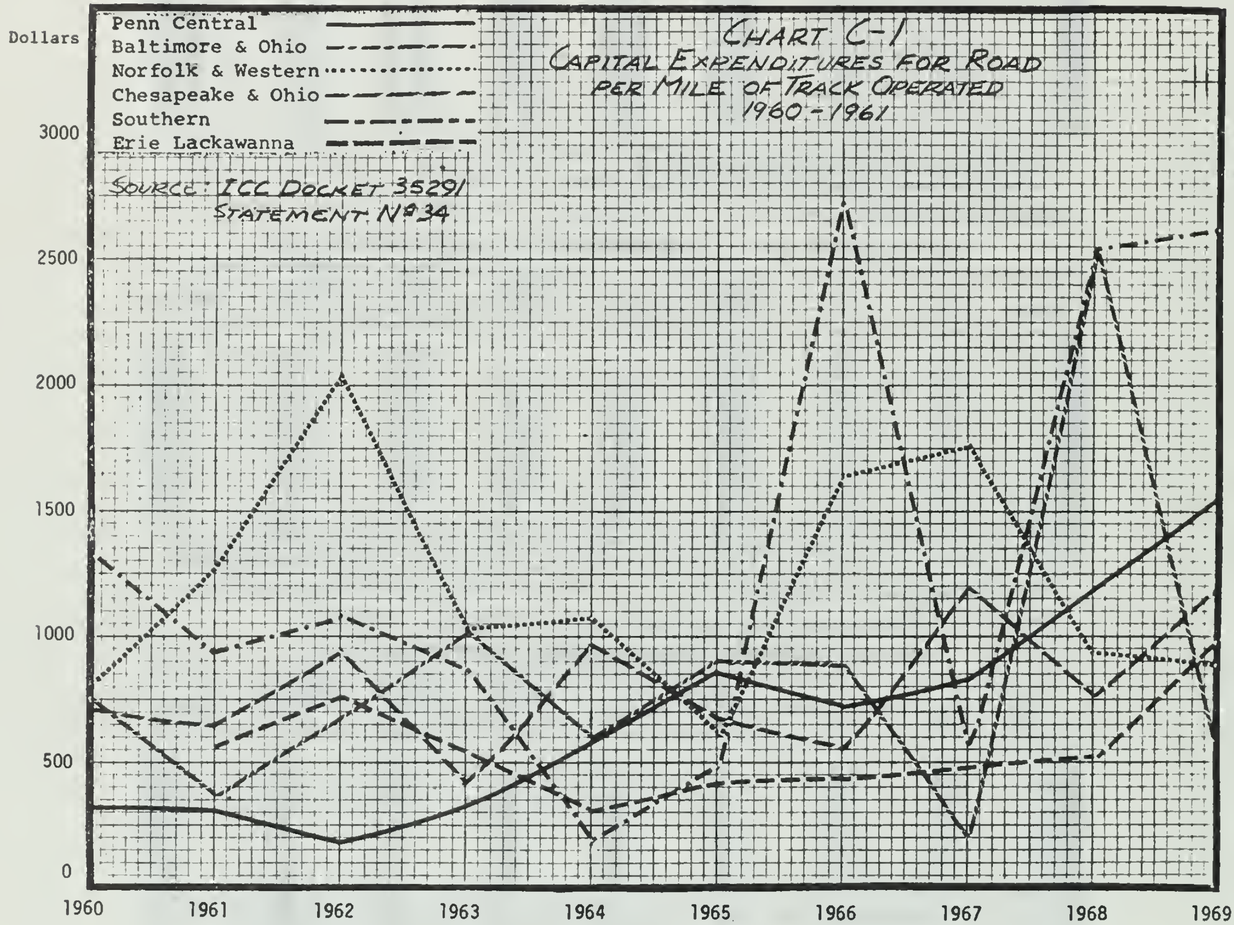
Source: A.A.R., O.S. series.

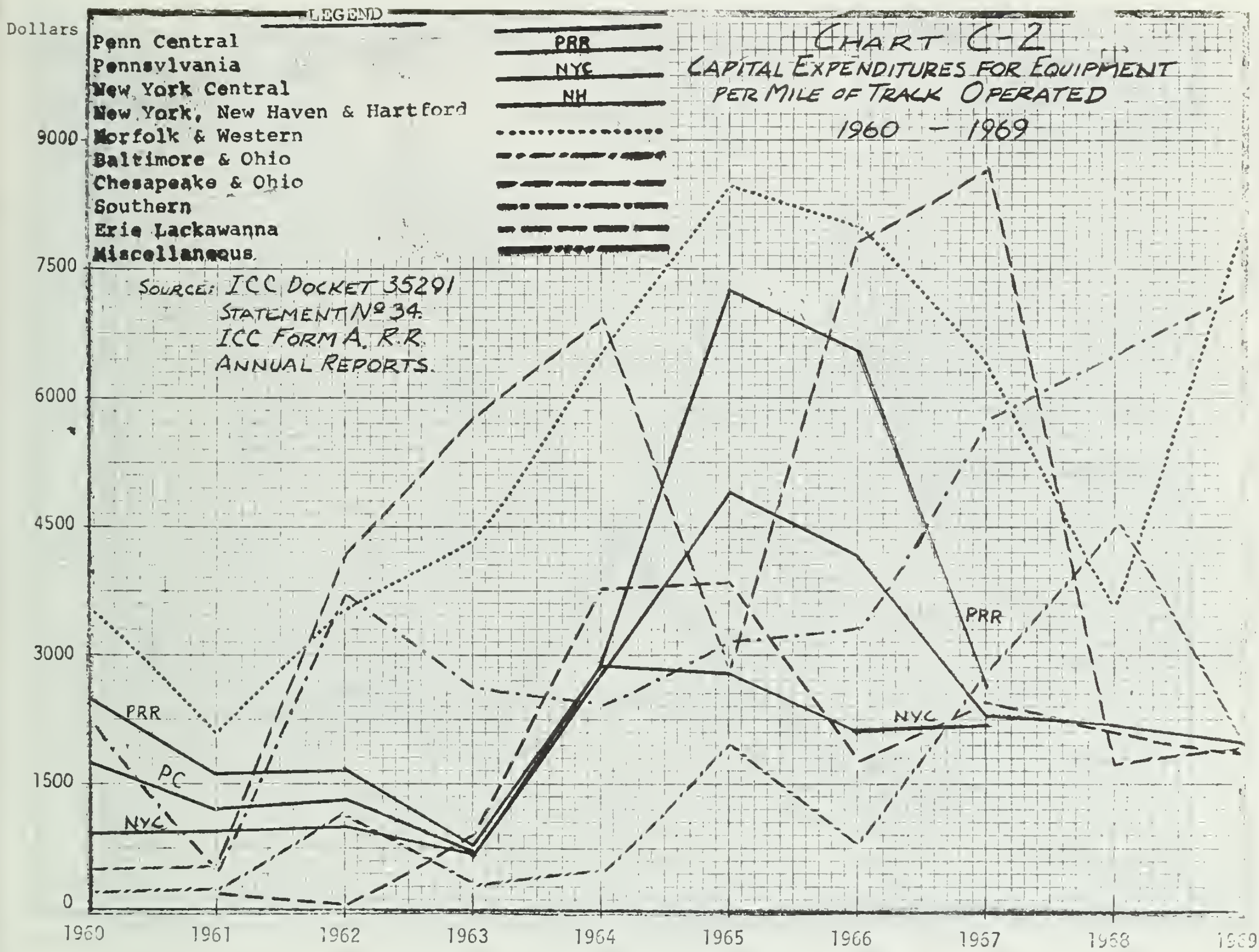
TABLE C-22.—NET TON-MILES PER FREIGHT CAR-DAY[1], SELECTED RAILROADS; 1958–70

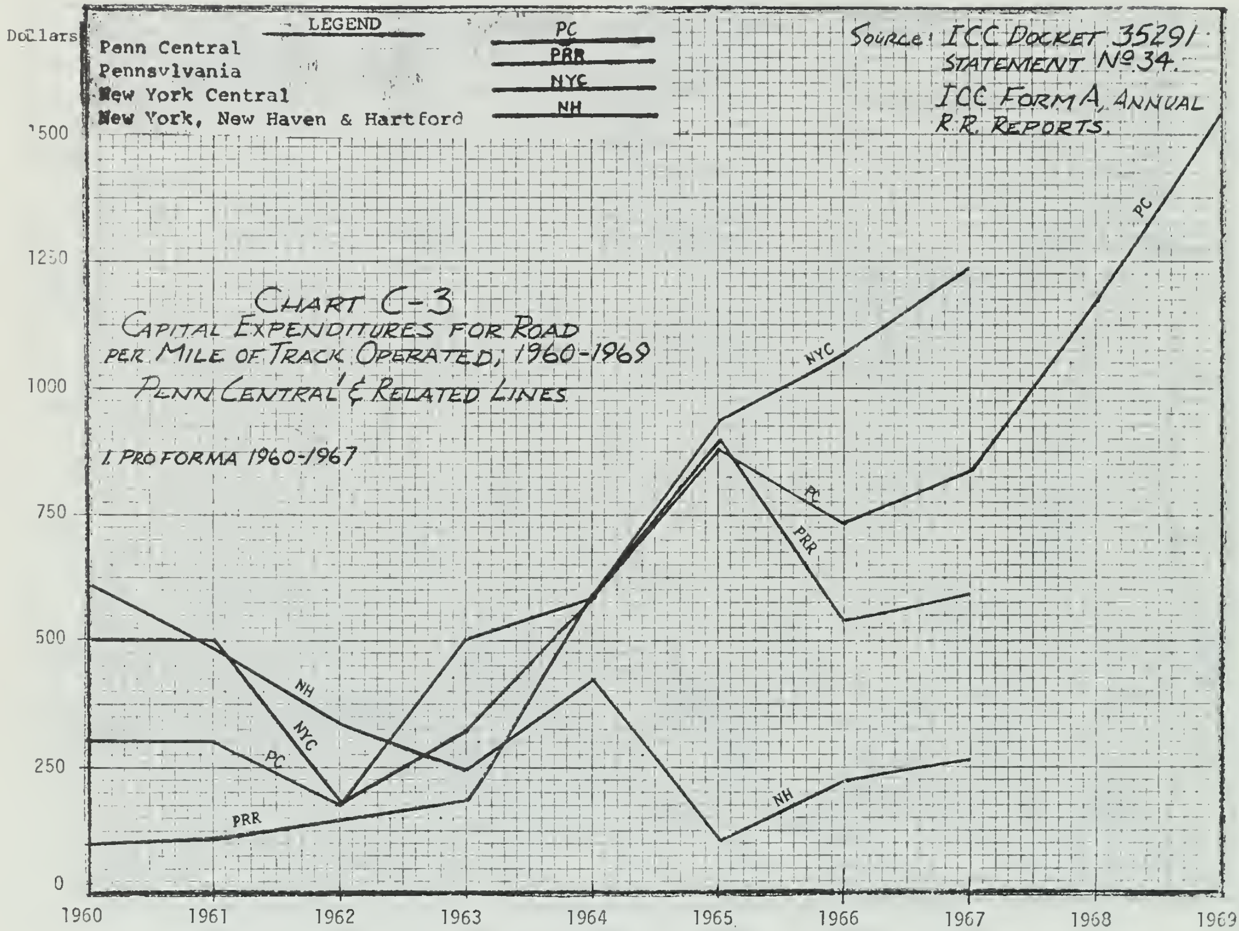
Year	Penn Central[2]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	1,033			1,302	1,432	1,543
1969	1,005			1,462	1,391	1,673
1968	980			1,529	1,367	1,390
1967	992	1,063	[3] 916	1,360	1,317	1,073
1966	1,049	1,113	[3] 974	1,324	1,400	1,077
1965	997	1,021	[3] 966	1,325	1,285	997
1964	955	989	908	1,074	1,168	1,040
1963	747	734	766	910	1,125	939
1962	708	694	729	767	999	990
1961	655	638	680	696	886	843
1960	652	635	676	722	896	800
1959	631	610	662	692	930	875
1958	566	589	582	647	926	817

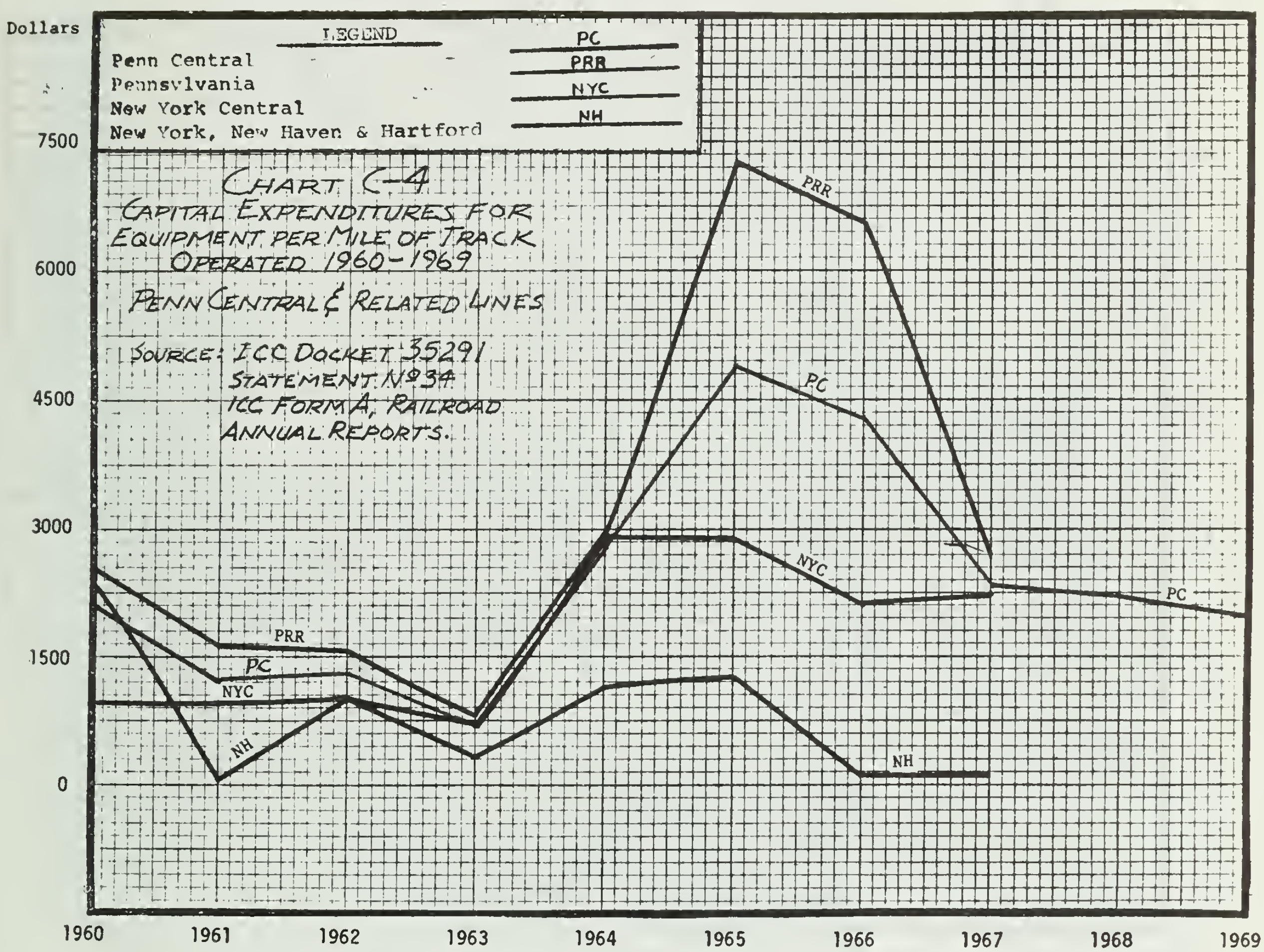
[1] Serviceable Freight Car-Days, only 1964–70.
[2] Pro forma combination of Pennsylvania R.R. and New York Central; 1958–67.
[3] Includes Pittsburgh & Lake Erie.

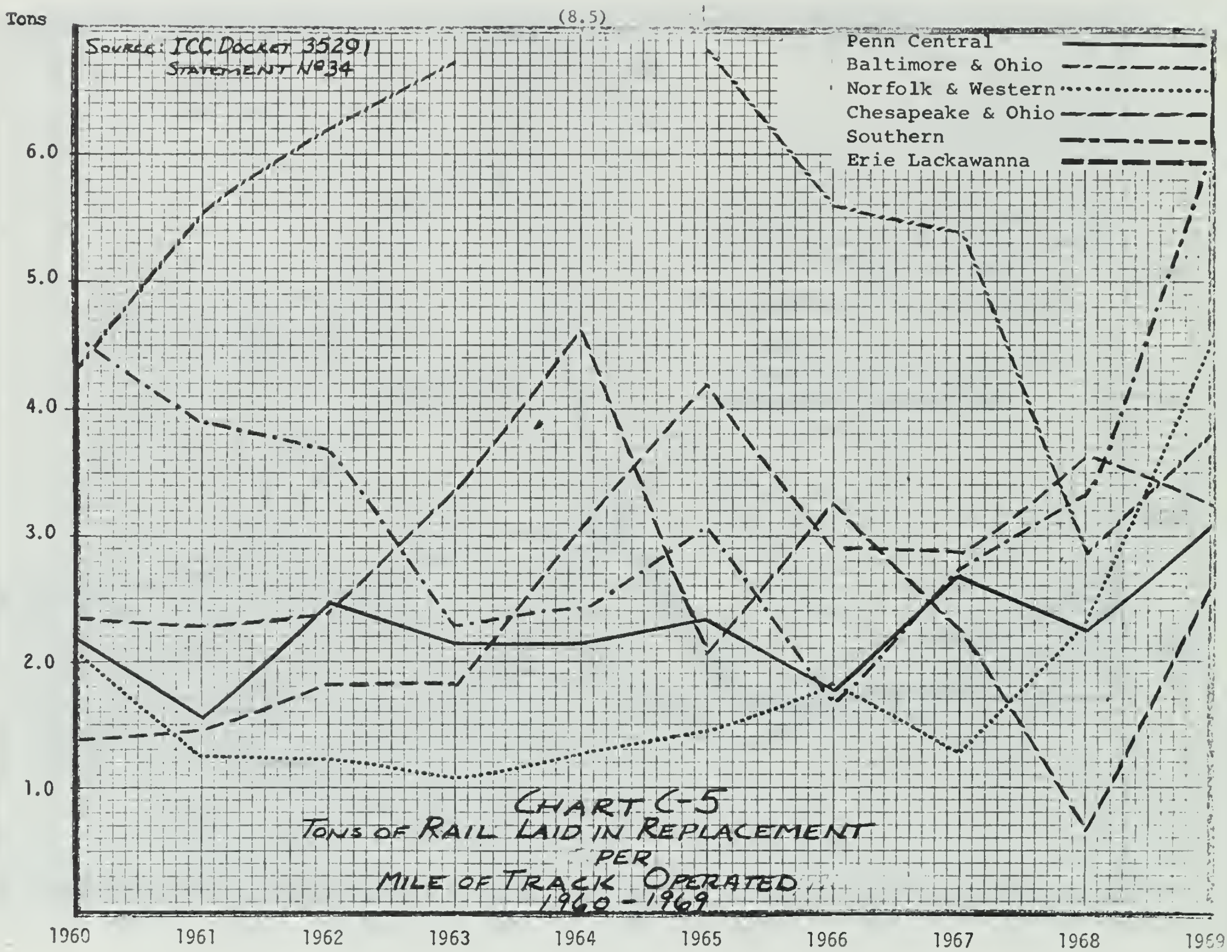
Source: AAR, O.S. Series.


Dollars
Penn Central
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-1
CAPITAL EXPENDITURES FOR ROAD
PER MILE OF TRACK OPERATED
1960-1961
SOURCE: ICC DOCKET 35291
STATEMENT Nº 34
3000
2500
2000
1500
1000
500
0
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969


Dollars
LEGEND
Penn Central
Pennsylvania
New York Central
New York, New Haven & Hartford
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
PRR
NYC
NH
CHART C-2
CAPITAL EXPENDITURES FOR EQUIPMENT
PER MILE OF TRACK OPERATED
1960 - 1969
SOURCE: ICC DOCKET 35291
STATEMENT Nº 34.
ICC FORM A, R.R.
ANNUAL REPORTS.
9000
7500
6000
4500
3000
1500
0
PRR
PC
NYC
NYC
PRR
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969


LEGEND
Penn Central PC
Pennsylvania PRR
New York Central NYC
New York, New Haven & Hartford NH
Source: ICC Docket 35291
Statement No. 34.
ICC Form A, Annual
R.R. Reports.
Chart C-3
Capital Expenditures for Road
per Mile of Track Operated, 1960-1969
Penn Central[1] & Related Lines
1. Pro Forma 1960-1967
Dollars
1500
1250
1000
750
500
250
0
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
PC
NYC
PRR
NH


Dollars
LEGEND
Penn Central
Pennsylvania
New York Central
New York, New Haven & Hartford
PC
PRR
NYC
NH
CHART C-4
CAPITAL EXPENDITURES FOR EQUIPMENT PER MILE OF TRACK OPERATED 1960-1969
PENN CENTRAL & RELATED LINES
SOURCE: ICC DOCKET 35291
STATEMENT NO 34
ICC FORM A, RAILROAD
ANNUAL REPORTS.
7500
6000
4500
3000
1500
0
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969


Tons
(8.5)
Source: ICC Docket 35291
Statement No 34
Penn Central
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
6.0
5.0
4.0
3.0
2.0
1.0
Chart C-5
Tons of Rail Laid in Replacement
per
Mile of Track Operated
1960 - 1969
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

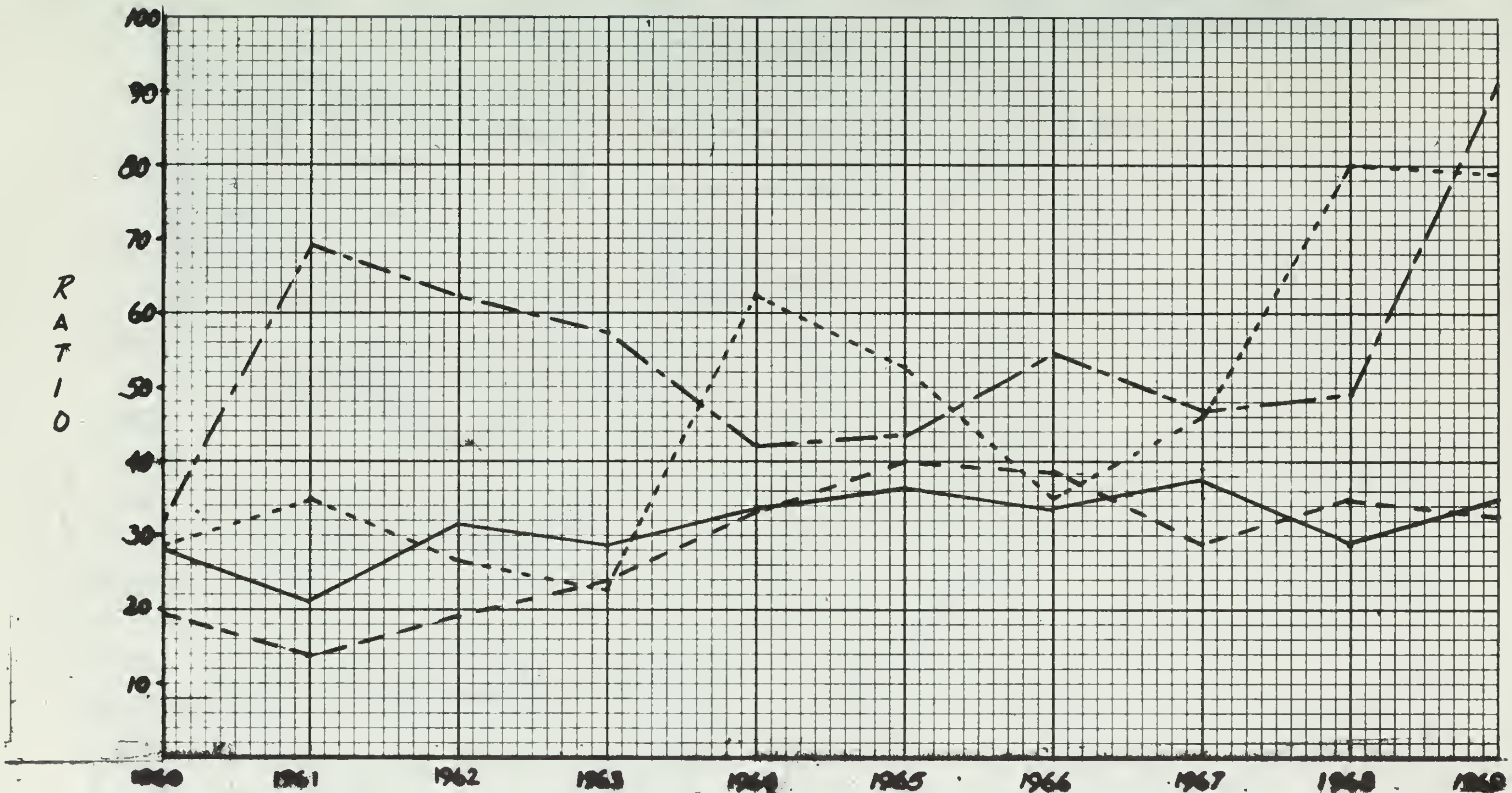


CHART C-6
CROSSTIES LAID PER MILE
OF TRACK OPERATED
SELECTED RAILROADS; 1960-69

LEGEND
PENN CENTRAL[1] ——————
BALTIMORE & OHIO —·—·—·—
CHESAPEAKE & OHIO — — — —
SOUTHERN - - - - - - -

SOURCE: MOODY'S
TRANSPORT

1. PRO FORMA 1960-1967.

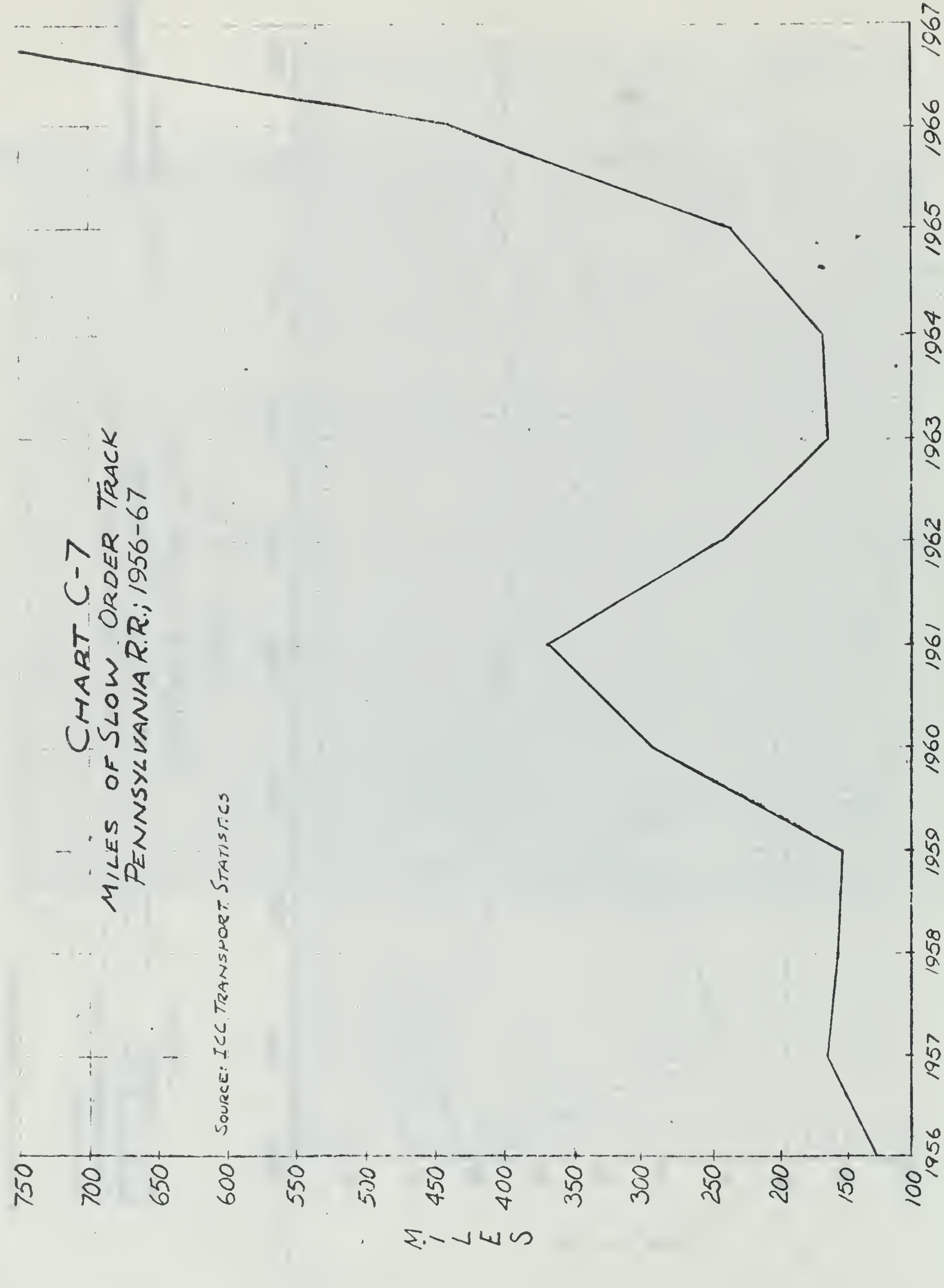
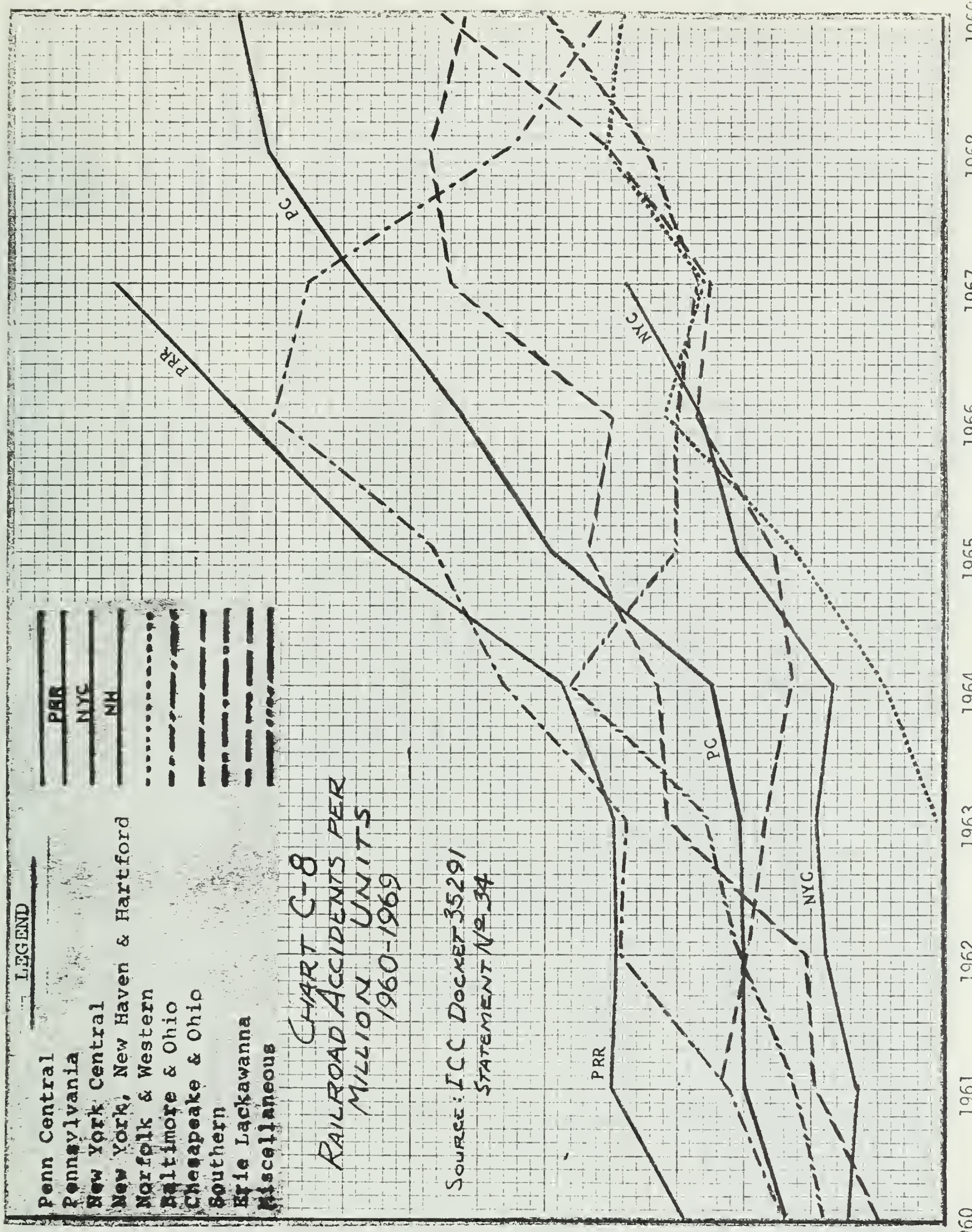


CHART C-7
MILES OF SLOW ORDER TRACK
PENNSYLVANIA R.R.; 1956-67
SOURCE: ICC TRANSPORT STATISTICS
MILES
750
700
650
600
550
500
450
400
350
300
250
200
150
100
1956
1957
1958
1959
1960
1961
1962
1963
1964
1965
1966
1967



LEGEND
Penn Central
Pennsylvania
New York Central
New York, New Haven & Hartford
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
PRR
NYC
NH
CHART C-8
RAILROAD ACCIDENTS PER
MILLION UNITS
1960-1969
SOURCE: ICC DOCKET 35291
STATEMENT No 34
PRR
PC
NYC
14
13
12
11
10
9
8
7
6
5
4
3
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

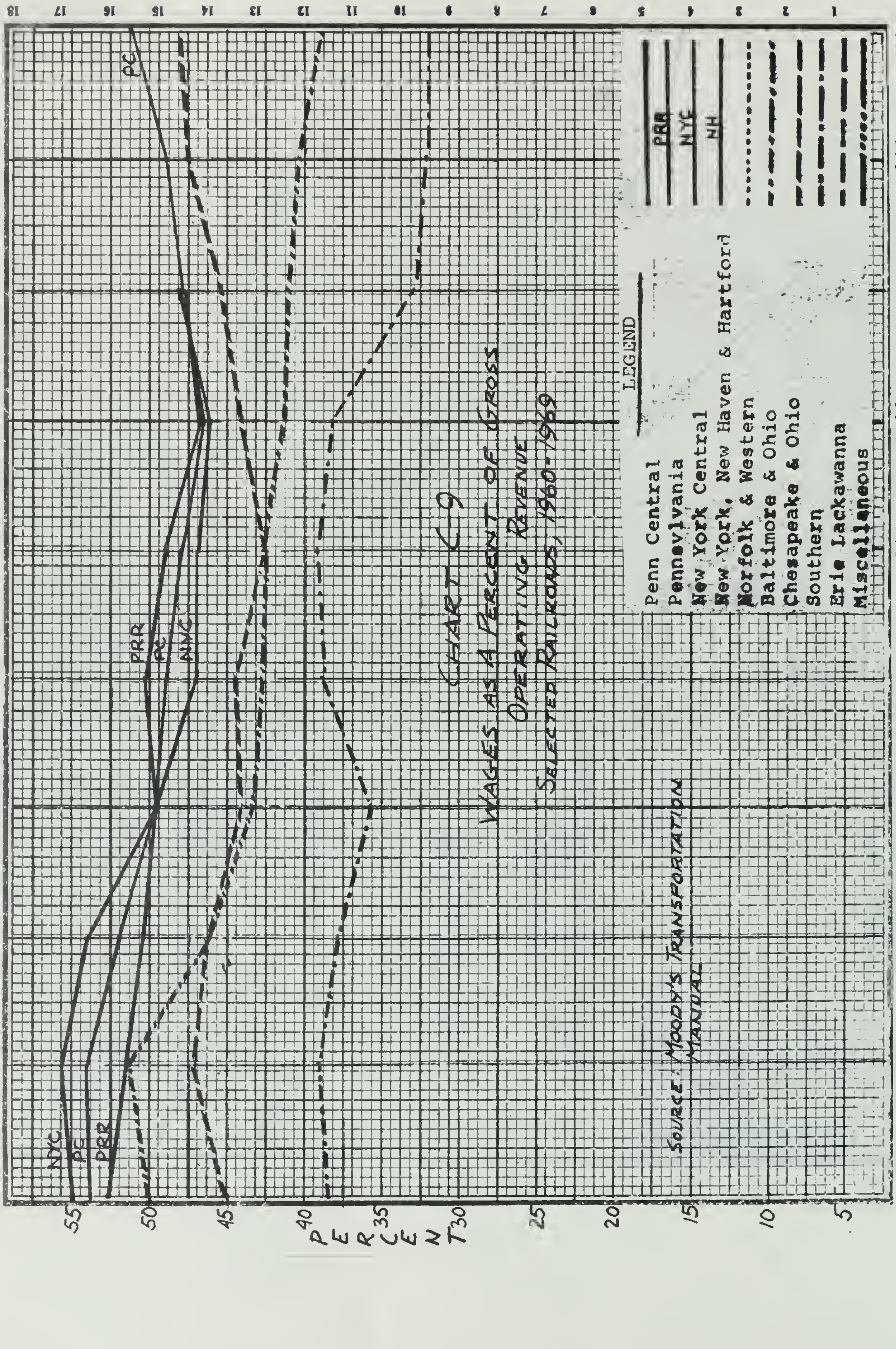


CHART C-9
WAGES AS A PERCENT OF GROSS
OPERATING REVENUE
SELECTED RAILROADS, 1960-1969
SOURCE: MOODY'S TRANSPORTATION MANUAL
LEGEND
Penn Central
Pennsylvania
New York Central
New York, New Haven & Hartford
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
PRR
NYC
NH
PC
PERCENT
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

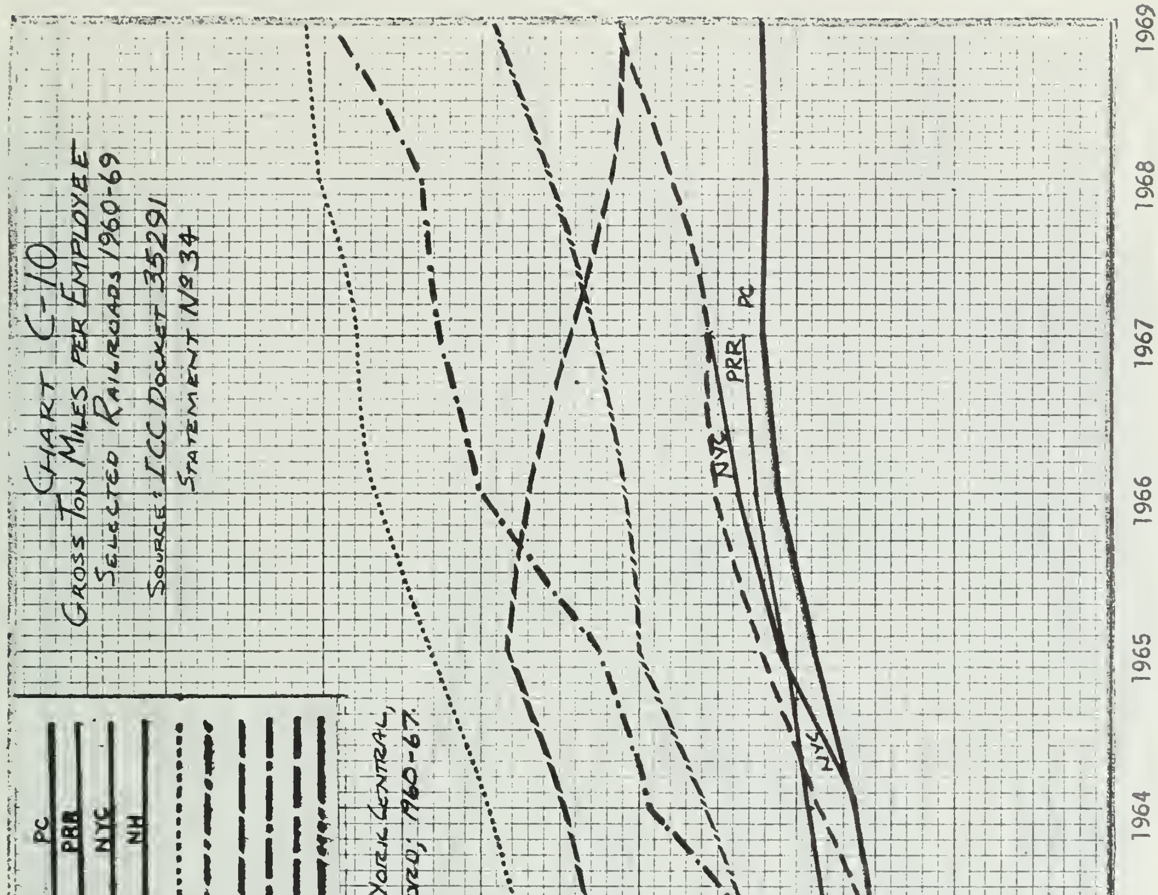


CHART C-10
GROSS TON MILES PER EMPLOYEE
SELECTED RAILROADS 1960-69
SOURCE: ICC DOCKET 35291
STATEMENT No 34
LEGEND
Penn Central
Pennsylvania
New York Central
New York, New Haven & Hartford
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
PC
PRR
NYC
NH
1. COMBINATION OF PENNSYLVANIA, NEW YORK CENTRAL, AND NEW YORK, NEW HAVEN & HARTFORD, 1960-67.
Millions
4.0
3.5
3.0
2.5
2.0
1.5
1960
1961
1962
1953
1964
1965
1966
1967
1968
1969

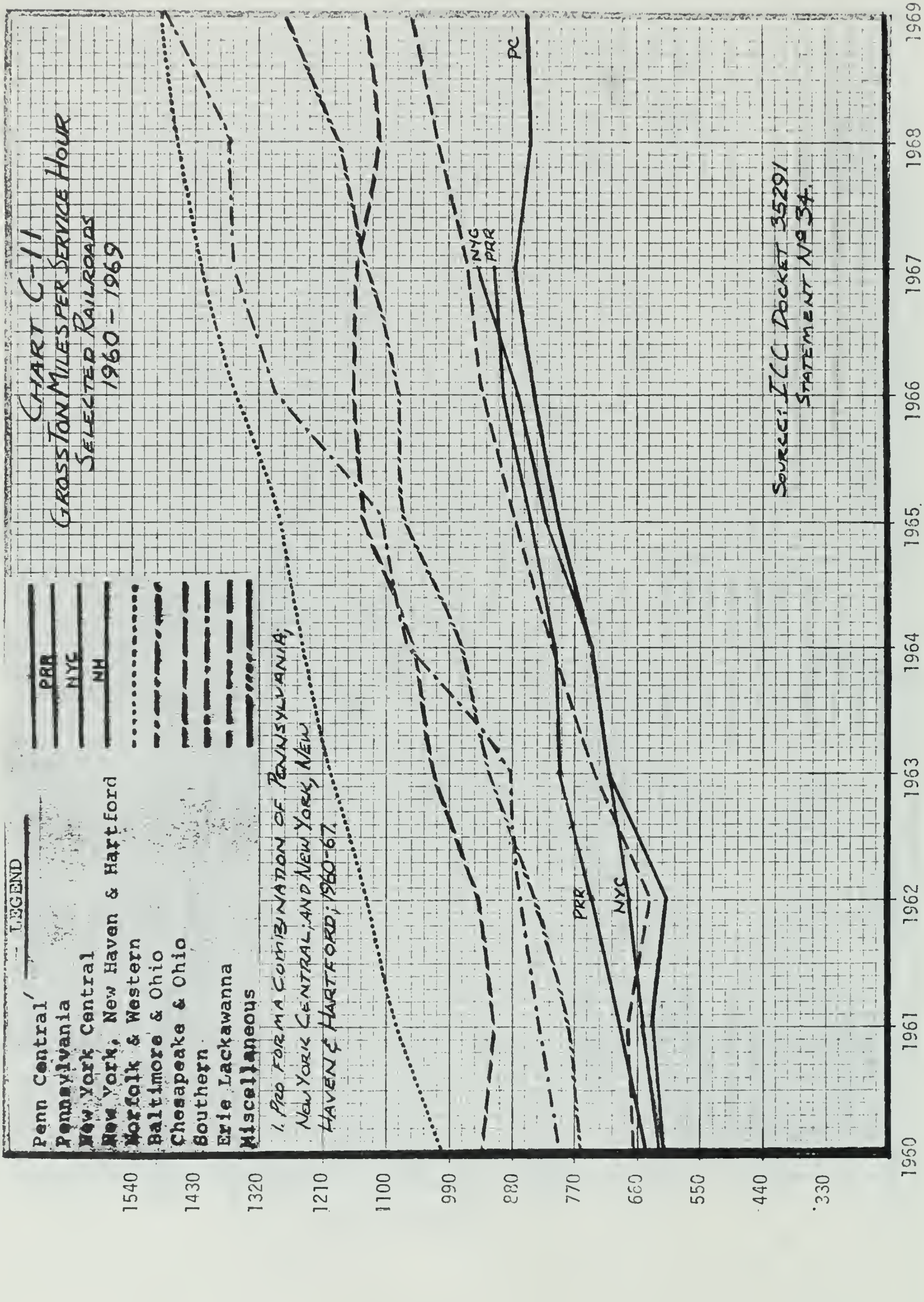


CHART C-11
GROSS TON MILES PER SERVICE HOUR
SELECTED RAILROADS
1960 – 1969
LEGEND
Penn Central[1]
Pennsylvania PRR
New York Central NYC
New York, New Haven & Hartford NH
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
1. PRO FORMA COMBINATION OF PENNSYLVANIA, NEW YORK CENTRAL, AND NEW YORK, NEW HAVEN & HARTFORD; 1960-67.
SOURCE: ICC DOCKET 35291
STATEMENT No 34.
PRR
NYC
NYG
PRR
PC
1540
1430
1320
1210
1100
990
880
770
660
550
440
330
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

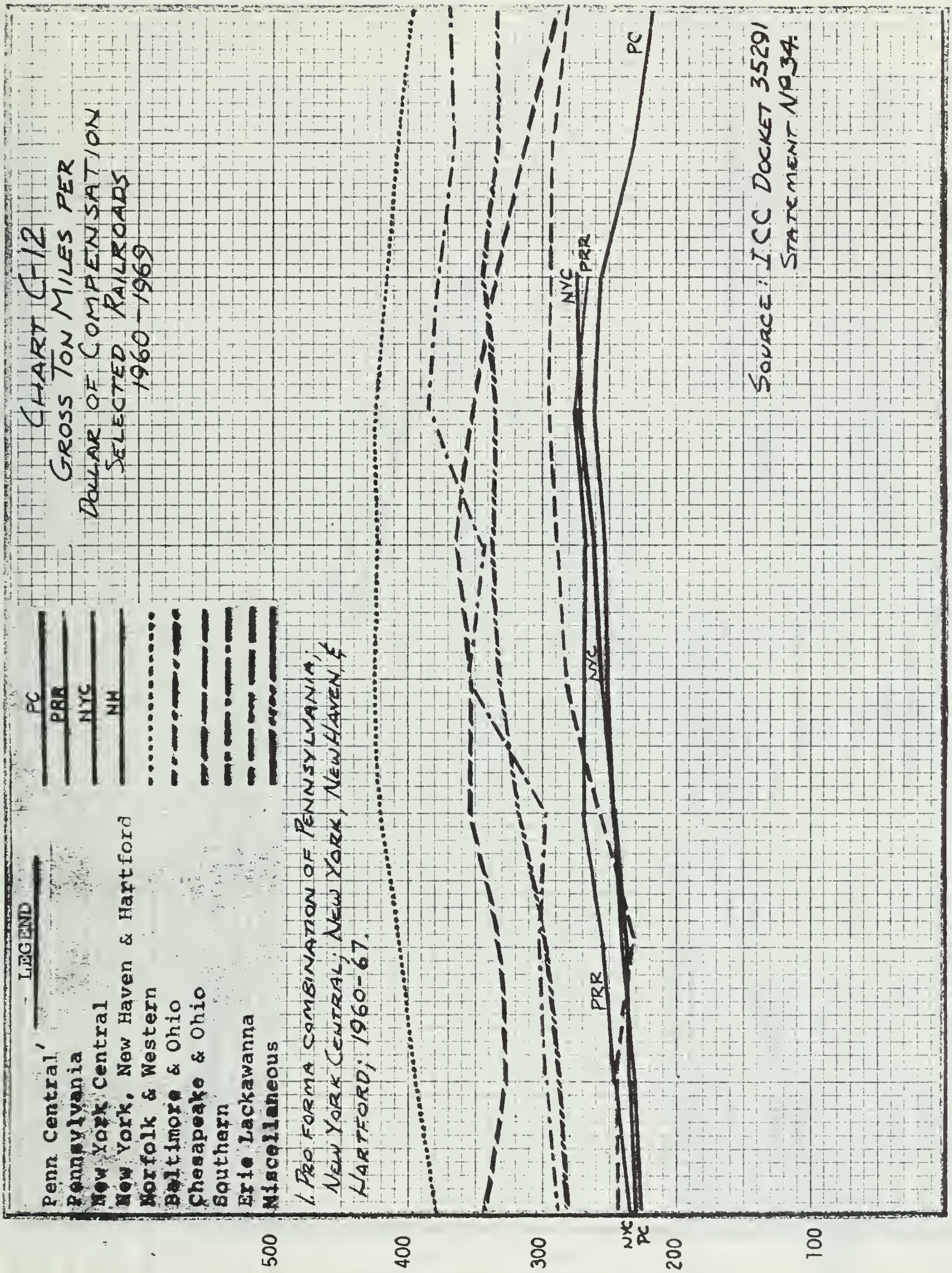


CHART C-12
GROSS TON MILES PER
DOLLAR OF COMPENSATION
SELECTED RAILROADS
1960-1969
LEGEND
Penn Central¹ PC
Pennsylvania PRR
New York Central NYC
New York, New Haven & Hartford NH
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
1 PRO FORMA COMBINATION OF PENNSYLVANIA, NEW YORK CENTRAL, NEW YORK, NEW HAVEN & HARTFORD; 1960-67.
SOURCE: I.C.C. DOCKET 35291
STATEMENT NO 34.
PRR
NYC
PC
500
400
300
200
100
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

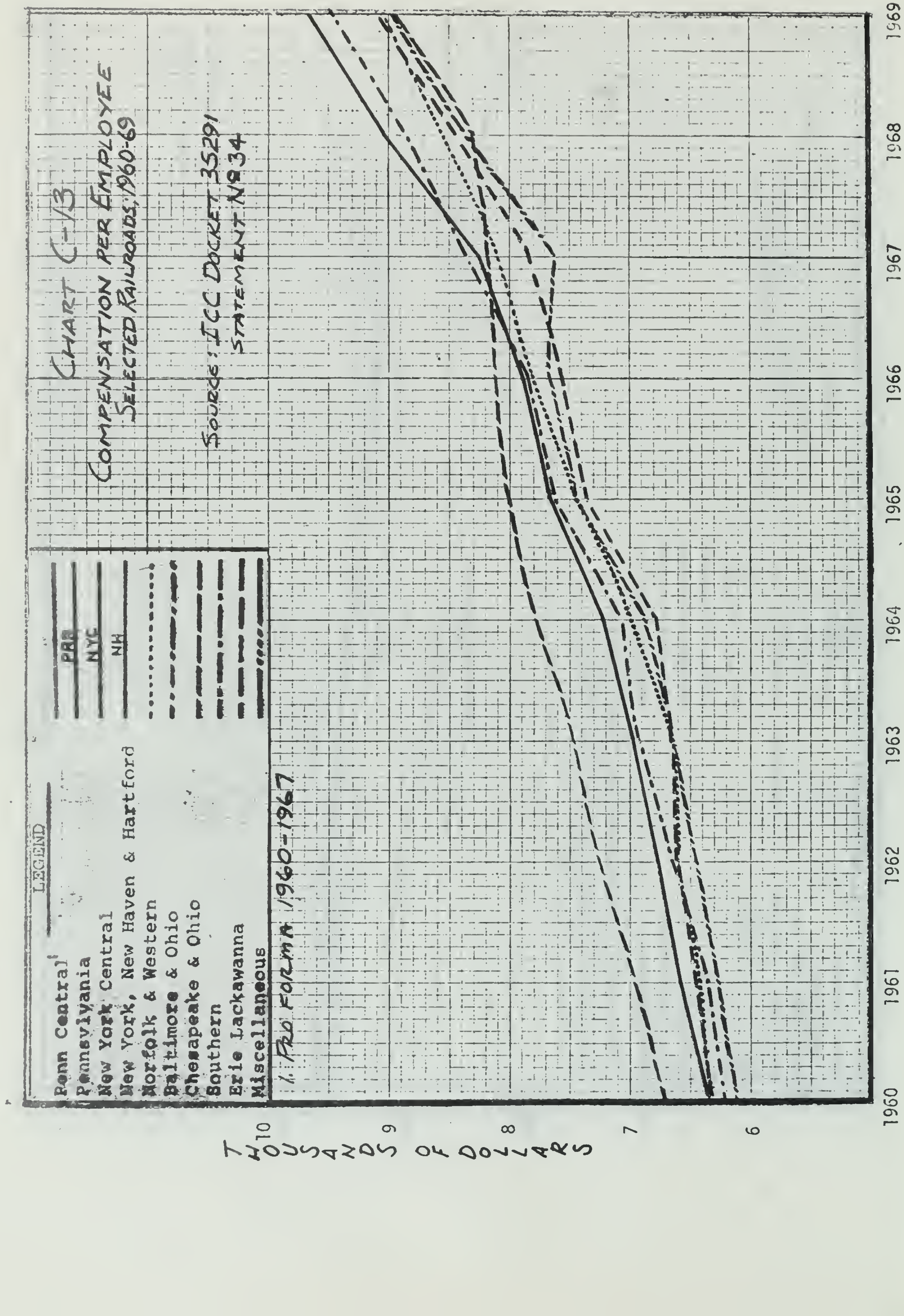


CHART C-13
COMPENSATION PER EMPLOYEE
SELECTED RAILROADS, 1960-69
SOURCE: ICC DOCKET 35291
STATEMENT NO 34
LEGEND
Penn Central[1]
Pennsylvania PRR
New York Central NYC
New York, New Haven & Hartford NH
Norfolk & Western
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
1. PRO FORMA 1960-1967
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
6
7
8
9
10
THOUSANDS OF DOLLARS

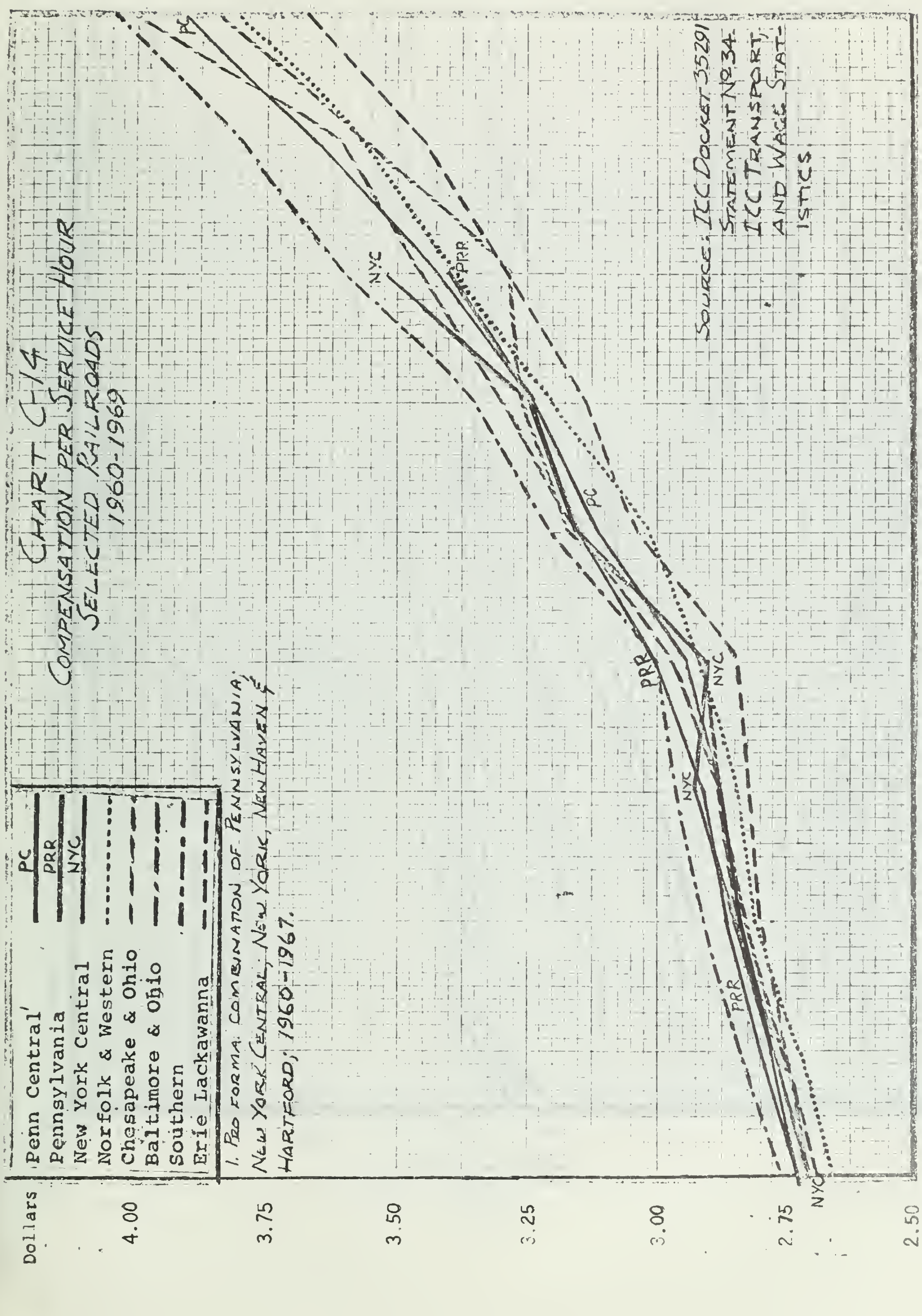


CHART C-14
COMPENSATION PER SERVICE HOUR
SELECTED RAILROADS
1960-1969
Dollars
4.00
3.75
3.50
3.25
3.00
2.75
2.50
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
Penn Central[1] PC
Pennsylvania PRR
New York Central NYC
Norfolk & Western
Chesapeake & Ohio
Baltimore & Ohio
Southern
Erie Lackawanna
1. PRO FORMA COMBINATION OF PENNSYLVANIA, NEW YORK CENTRAL, NEW YORK, NEW HAVEN & HARTFORD; 1960-1967.
PC
PRR
NYC
SOURCE: ICC DOCKET 35291 STATEMENT No 34. ICC TRANSPORT AND WAGE STATISTICS

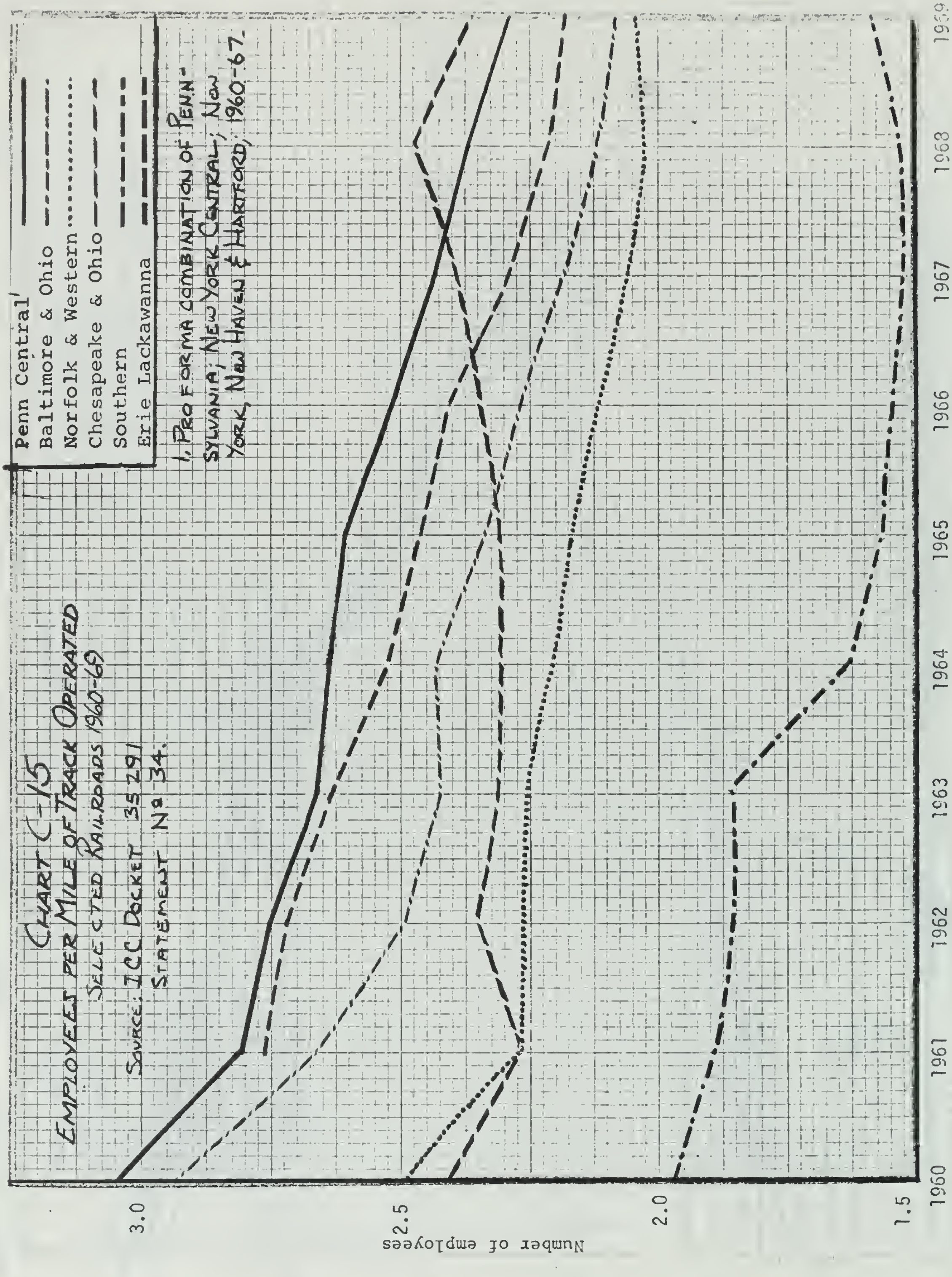
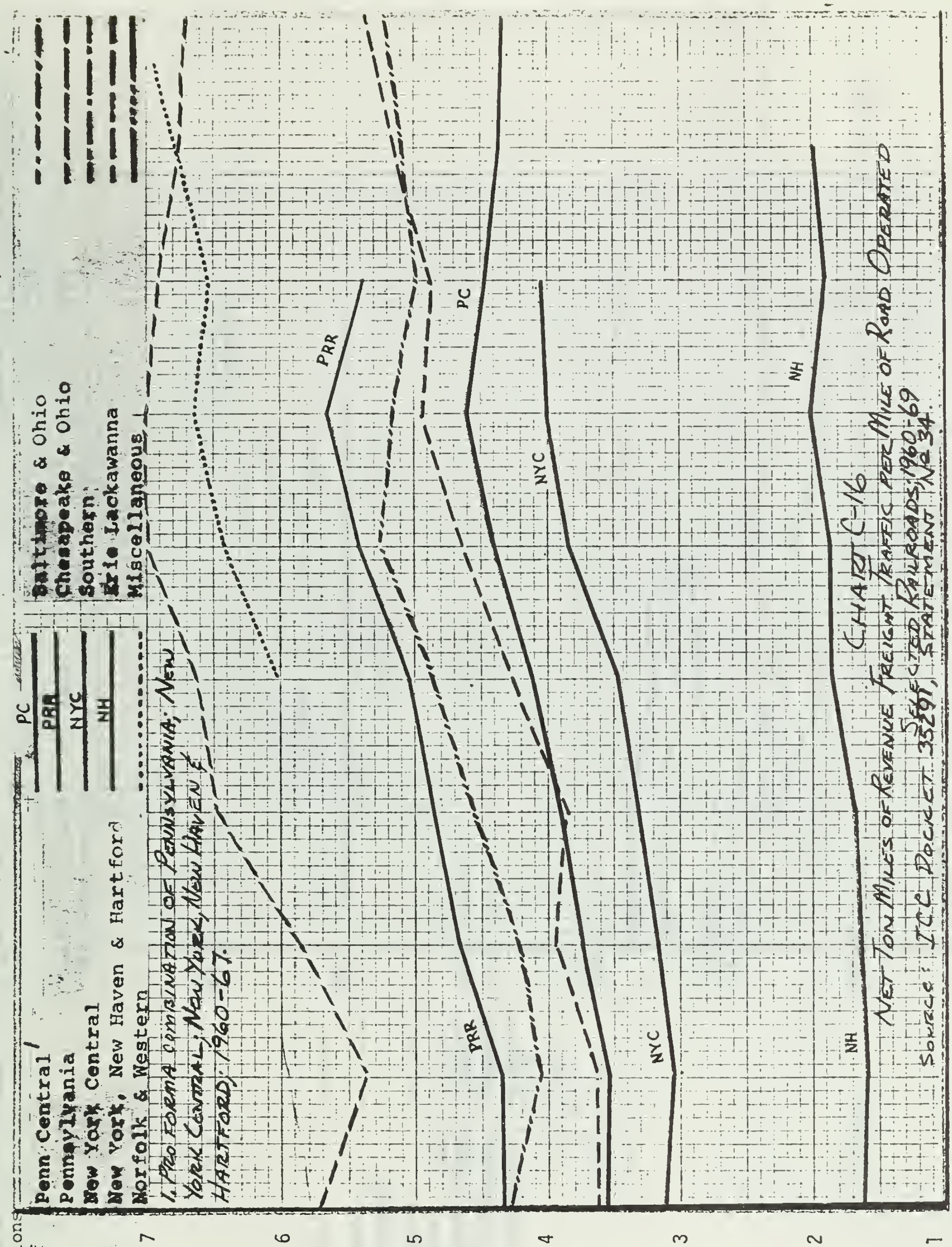
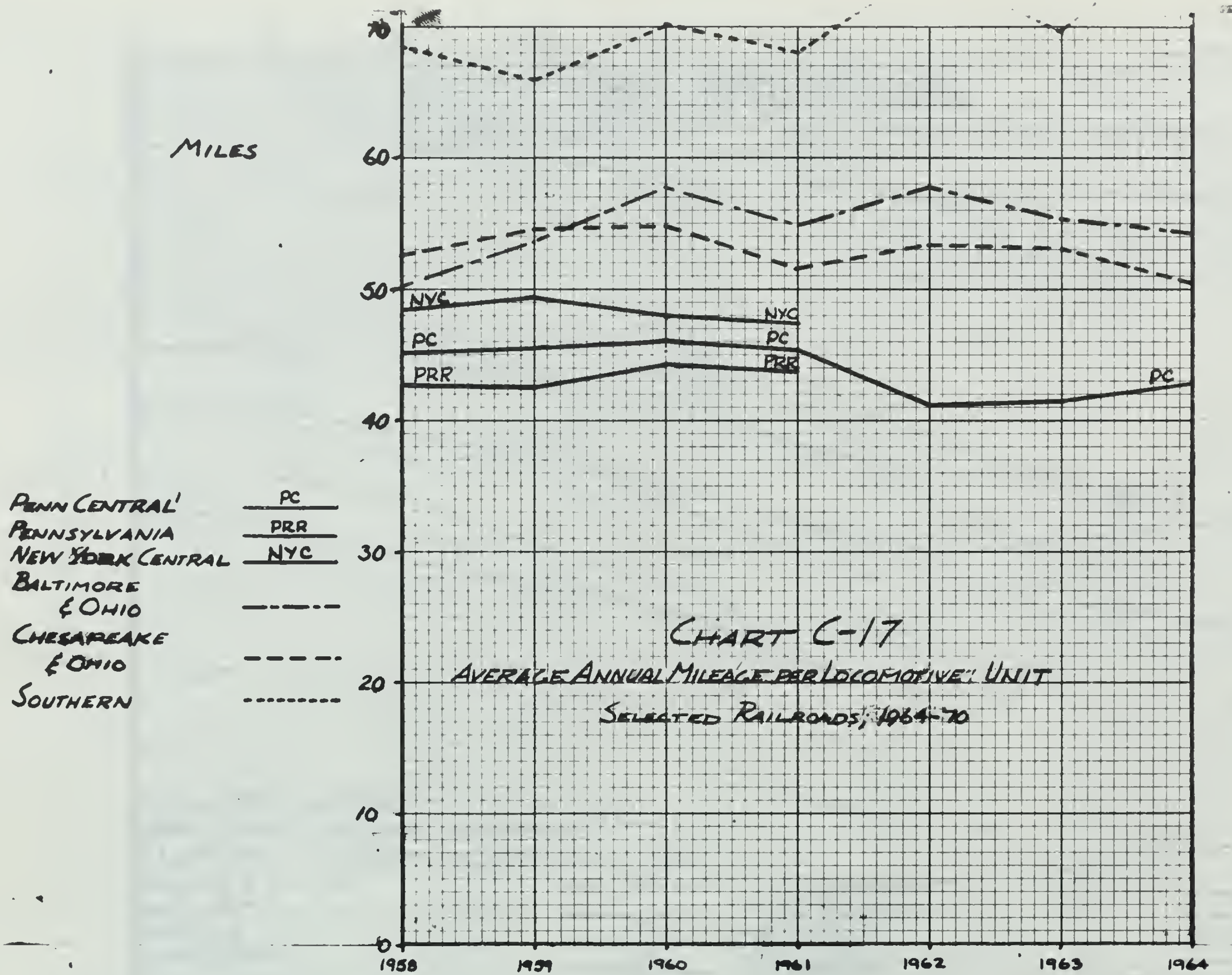


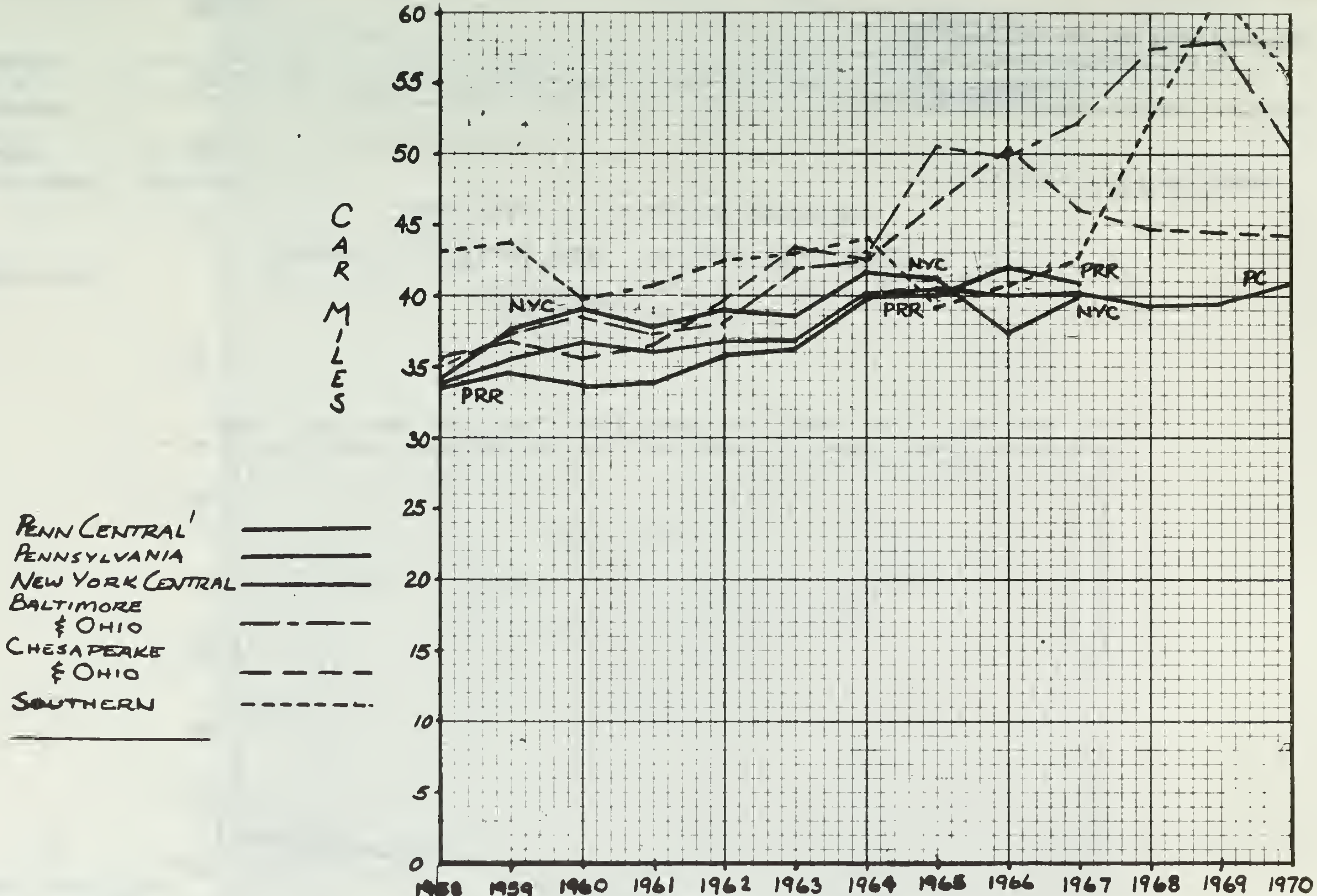
CHART C-15
EMPLOYEES PER MILE OF TRACK OPERATED
SELECTED RAILROADS 1960-69
SOURCE: ICC DOCKET 35291
STATEMENT No 34.
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1, PRO FORMA COMBINATION OF PENNSYLVANIA; NEW YORK CENTRAL; NEW YORK, NEW HAVEN & HARTFORD; 1960-67.
Number of employees
3.0
2.5
2.0
1.5
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969


Millions of
1
2
3
4
5
6
7
1960
1961
1962
1963
1964
1965
1966
1967
Penn Central[1]
Pennsylvania
New York Central
New York, New Haven & Hartford
Norfolk & Western
PC
PRR
NYC
NH
Baltimore & Ohio
Chesapeake & Ohio
Southern
Erie Lackawanna
Miscellaneous
1. PRO FORMA COMBINATION OF PENNSYLVANIA; NEW YORK CENTRAL; NEW YORK, NEW HAVEN & HARTFORD; 1960-67.
PRR
NYC
NH
PC
CHART C-16
NET TON MILES OF REVENUE FREIGHT TRAFFIC PER MILE OF ROAD OPERATED
SELECTED RAILROADS, 1960-69
SOURCE: ICC DOCKET 35291, STATEMENT No 34.



1. PRO FORMA COMBINATION OF PENNSYLVANIA, AND NEW YORK CENTRAL; 1964-67.

SOURCE: I.C.C. TRANSPORT STATISTICS



SOURCE: AAR, O.S. SERIES

CHART C-18

CAR MILES PER SERVICEABLE FREIGHT CAR DAY

SELECTED RAILROADS 1958-70

1. PRO FORMA COMBINATION OF PENNSYLVANIA, AND NEW YORK CENTRAL; 1958-67.

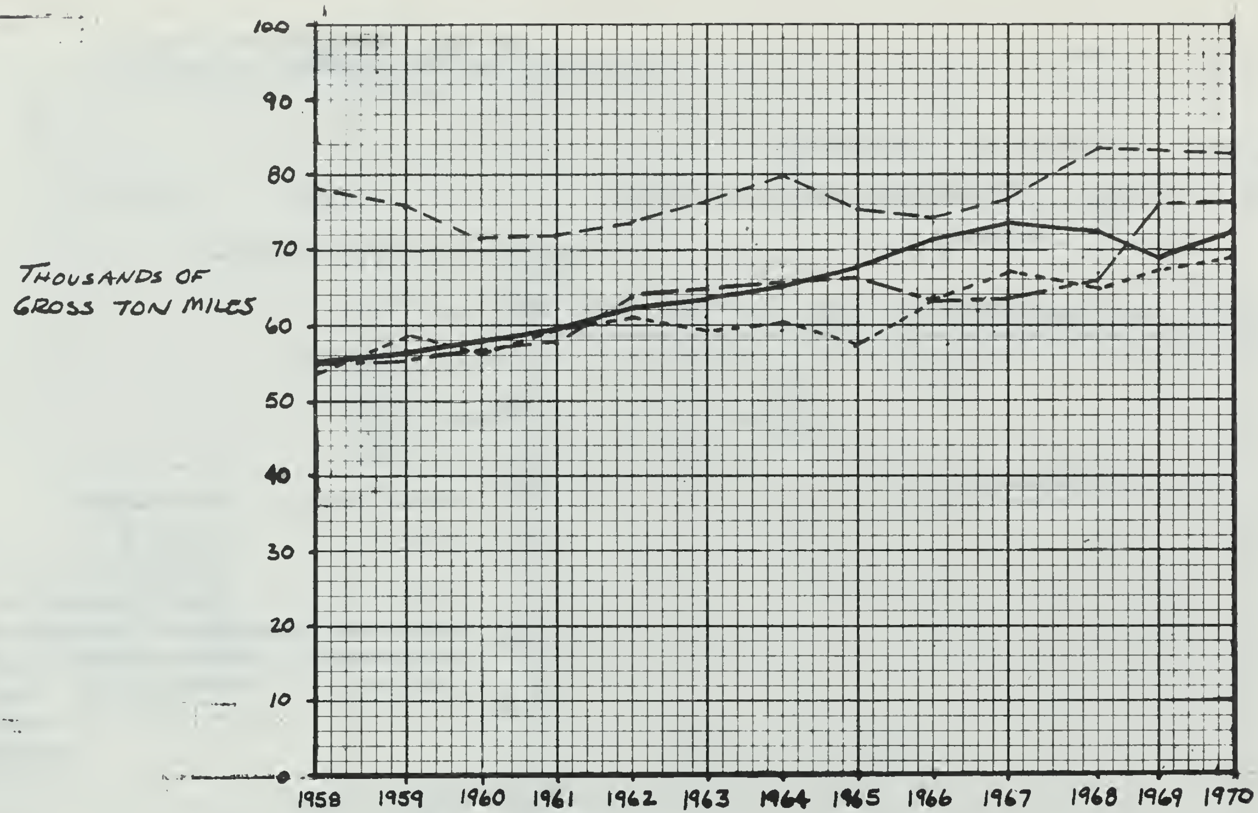


CHART C-19
GROSS TON MILES[1] PER FREIGHT TRAIN HOUR
SELECTED RAILROADS; 1958-70

PENN CENTRAL[2]
BALTIMORE & OHIO
CHESAPEAKE & OHIO
SOUTHERN

SOURCE: AAR, O.S. SERIES

1. GROSS TON MILES OF CARS, CONTENTS, AND CABOOSES.
2. PRO FORMA COMBINATION OF PENNSYLVANIA, AND NEW YORK CENTRAL; 1958-67.

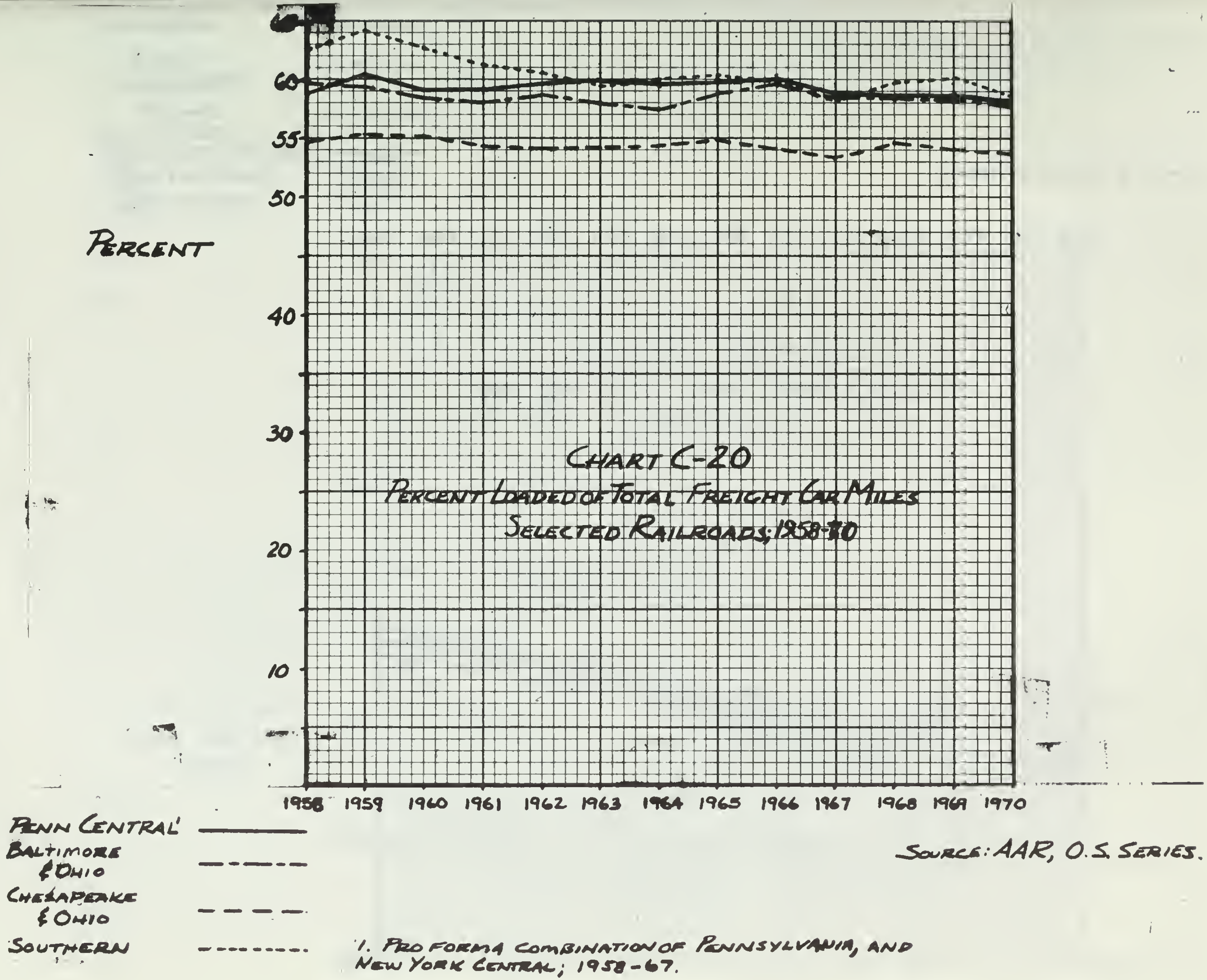


CHART C-20
PERCENT LOADED OF TOTAL FREIGHT CAR MILES
SELECTED RAILROADS; 1958-70
PERCENT
60
55
50
40
30
20
10
1958 1959 1960 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970
PENN CENTRAL[1]
BALTIMORE & OHIO
CHESAPEAKE & OHIO
SOUTHERN
SOURCE: AAR, O.S. SERIES.
1. PRO FORMA COMBINATION OF PENNSYLVANIA, AND NEW YORK CENTRAL; 1958-67.

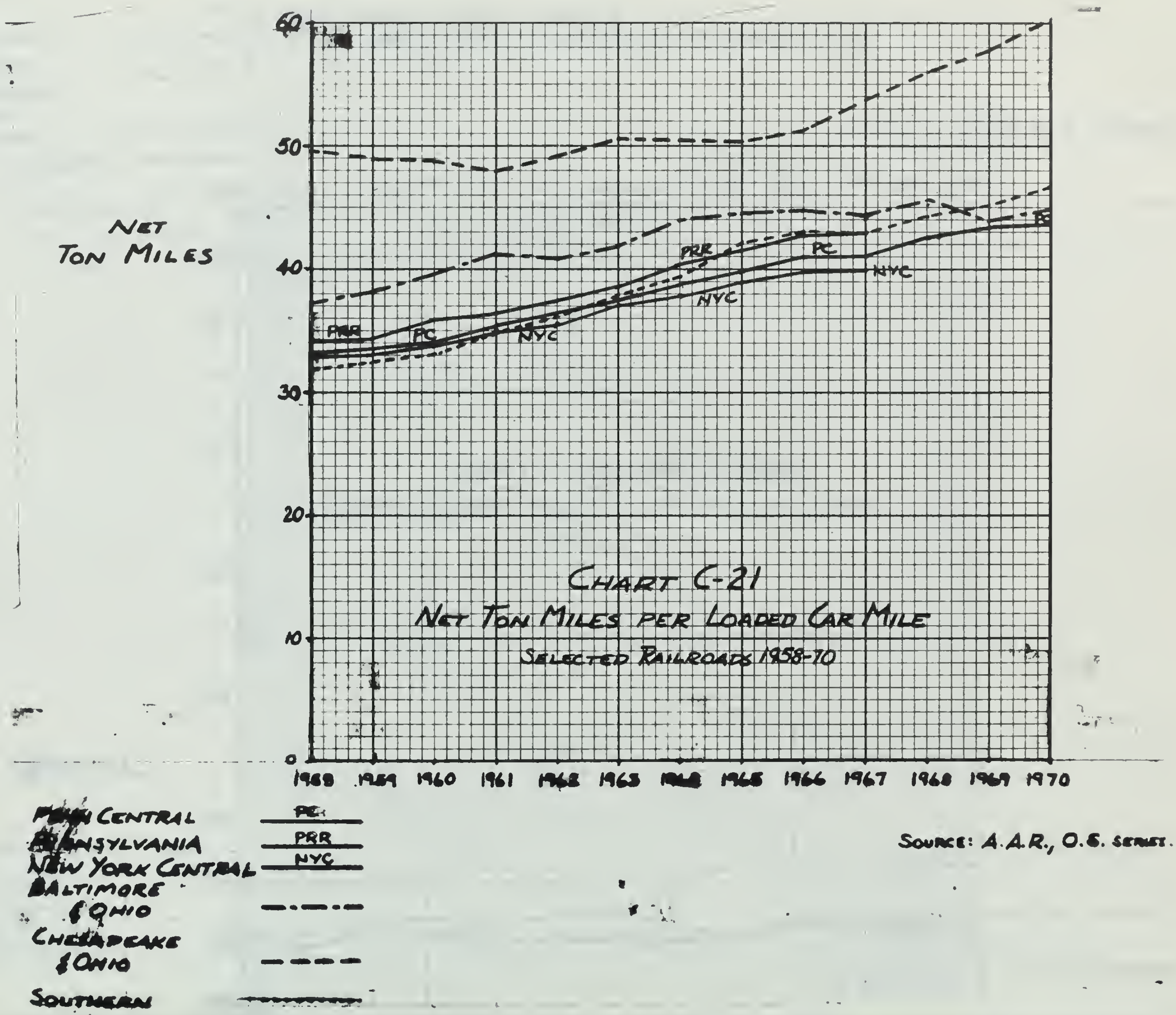


Chart C-21
Net Ton Miles per Loaded Car Mile
Selected Railroads 1958-70
Net
Ton Miles
60
50
40
30
20
10
0
1958
1959
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
1970
PRR
PC
NYC
Central
nsylvania
New York Central
Baltimore
& Ohio
Chesapeake
& Ohio
Southern
Source: A.A.R., O.S. series.

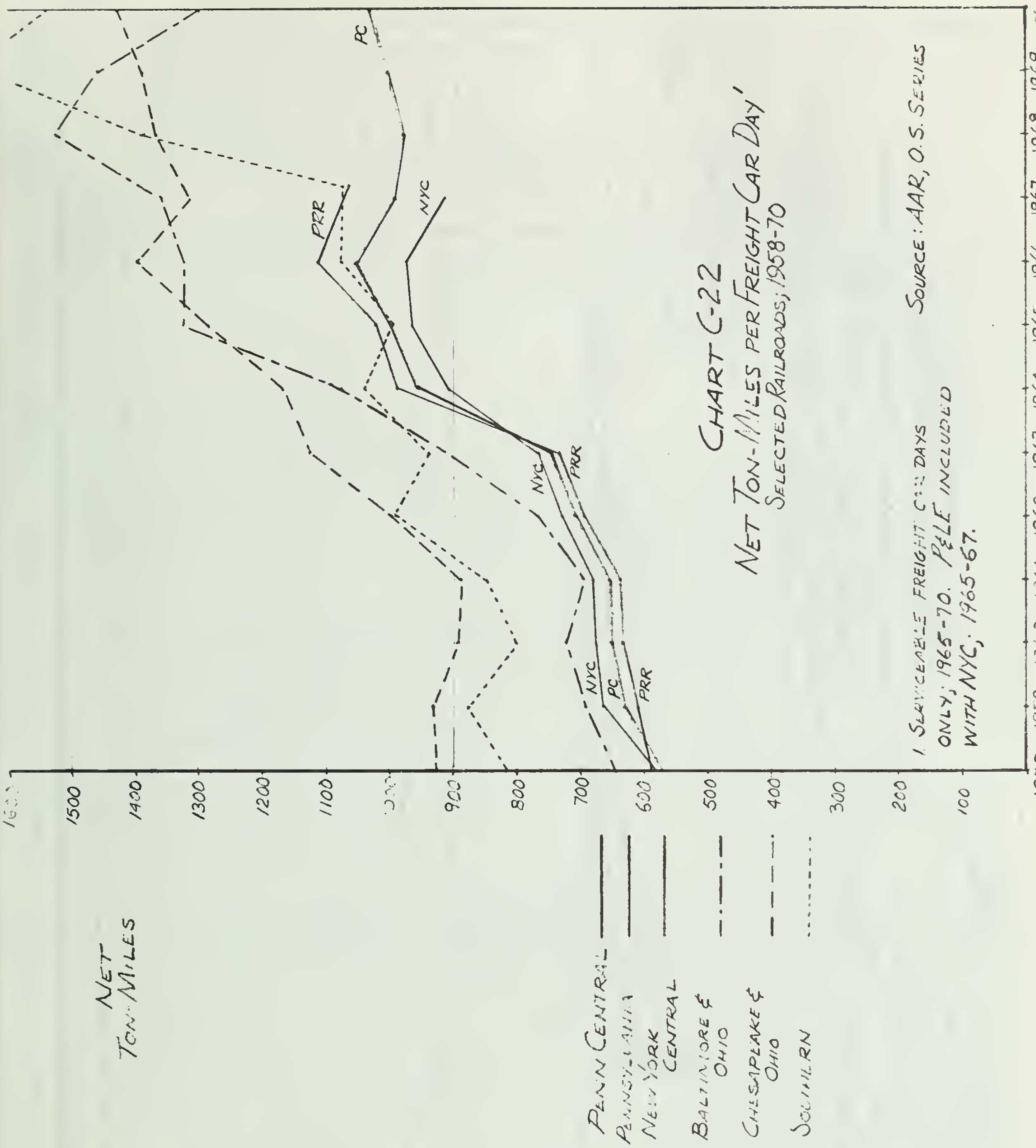


CHART C-22
NET TON-MILES PER FREIGHT CAR DAY¹
SELECTED RAILROADS; 1958-70
1. SERVICEABLE FREIGHT CAR DAYS ONLY; 1965-70. P&LE INCLUDED WITH NYC; 1965-67.
SOURCE: AAR, O.S. SERIES
NET TON-MILES
PENN CENTRAL
PENNSYLVANIA
NEW YORK CENTRAL
BALTIMORE & OHIO
CHESAPEAKE & OHIO
SOUTHERN
PC
PRR
NYC
1500
1400
1300
1200
1100
900
800
700
600
500
400
300
200
100
1958
1959
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

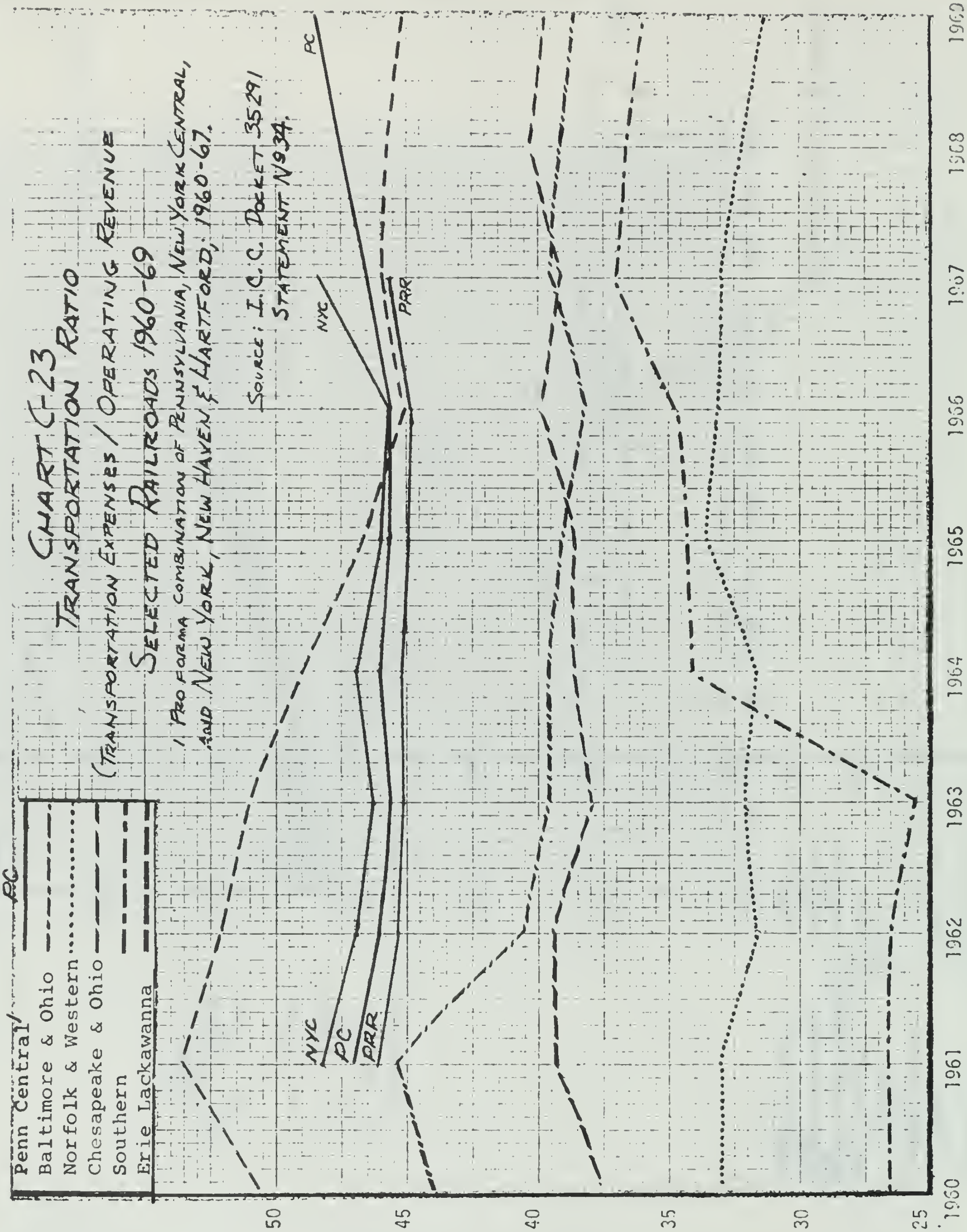
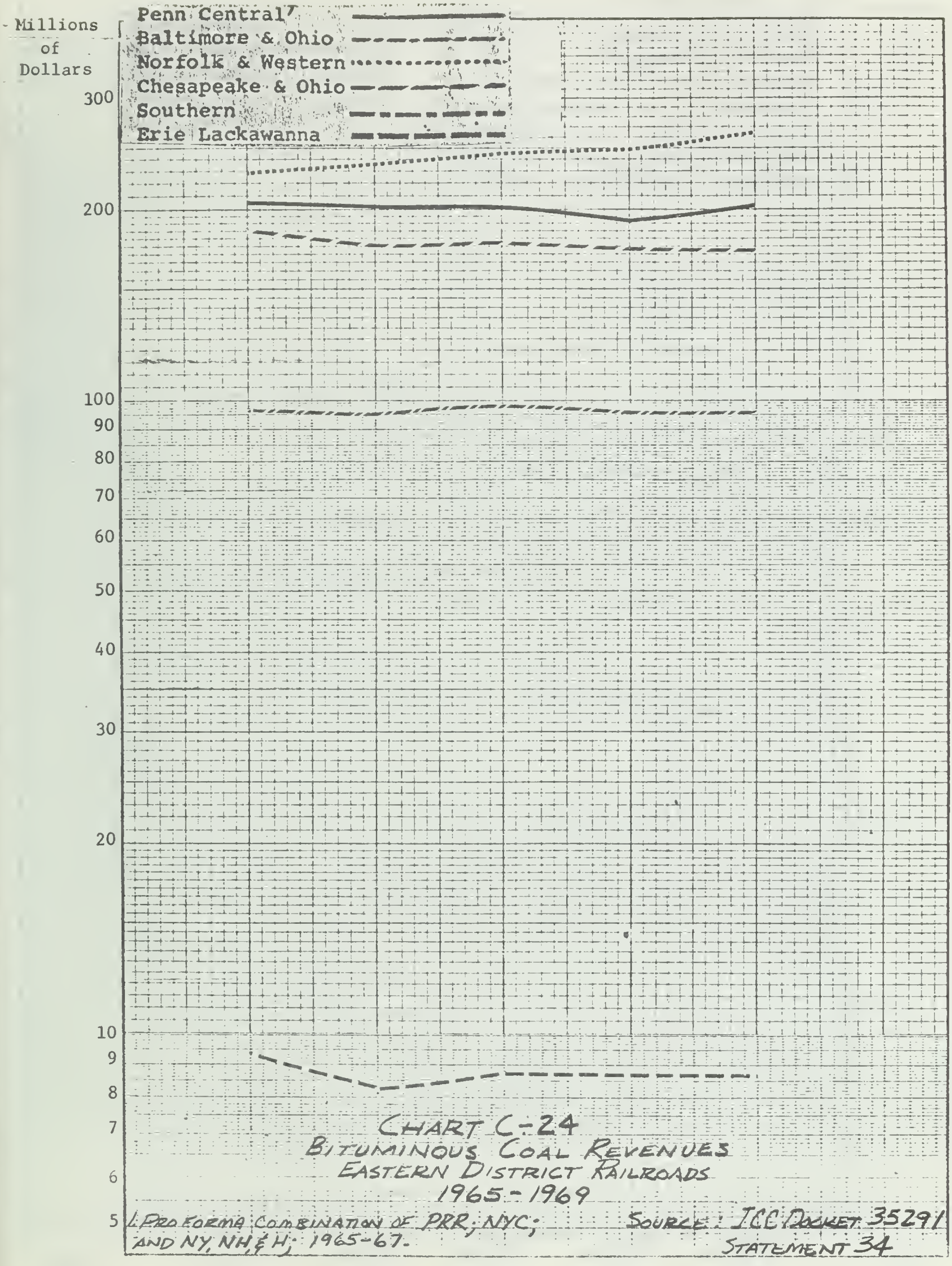
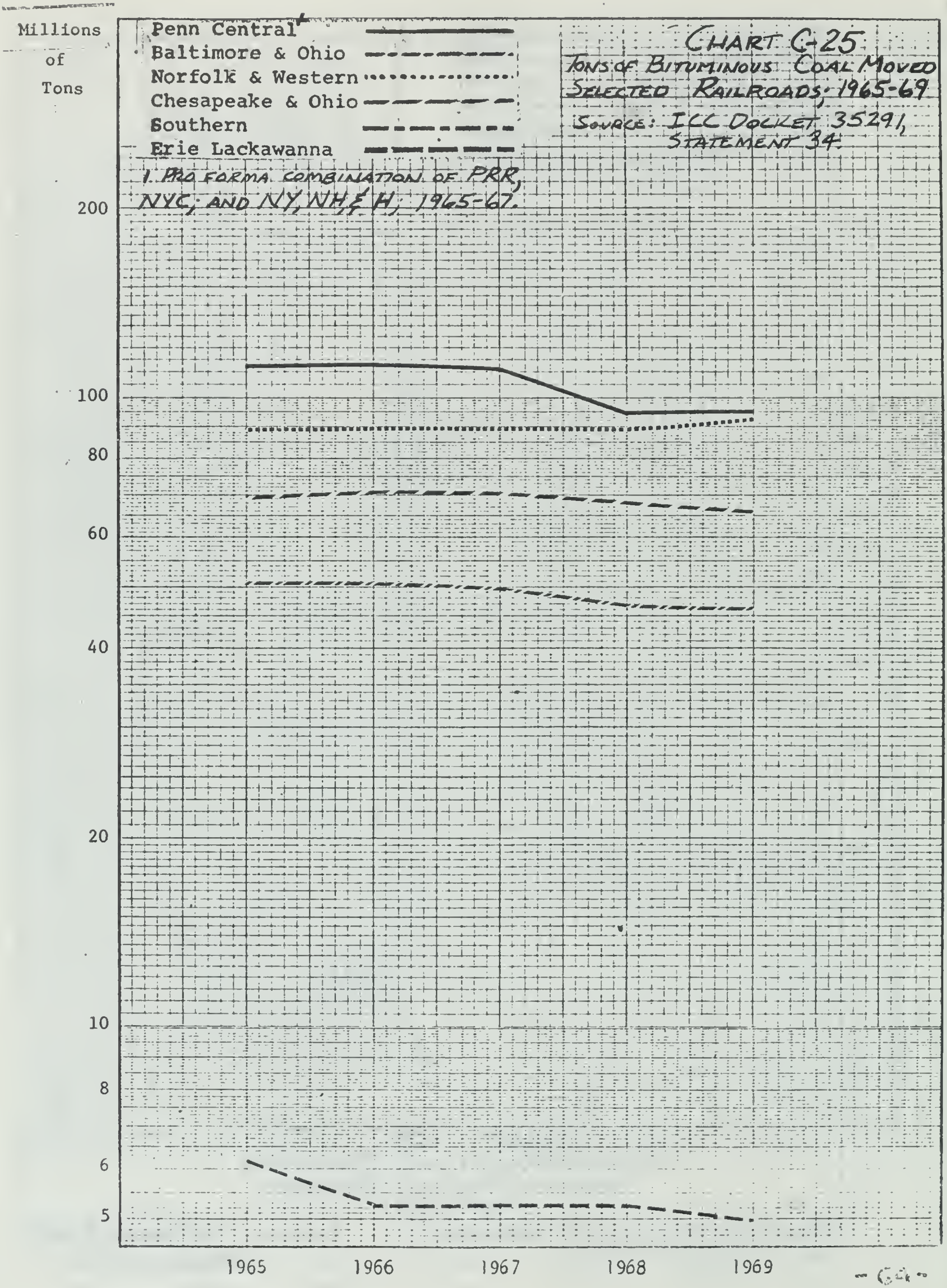
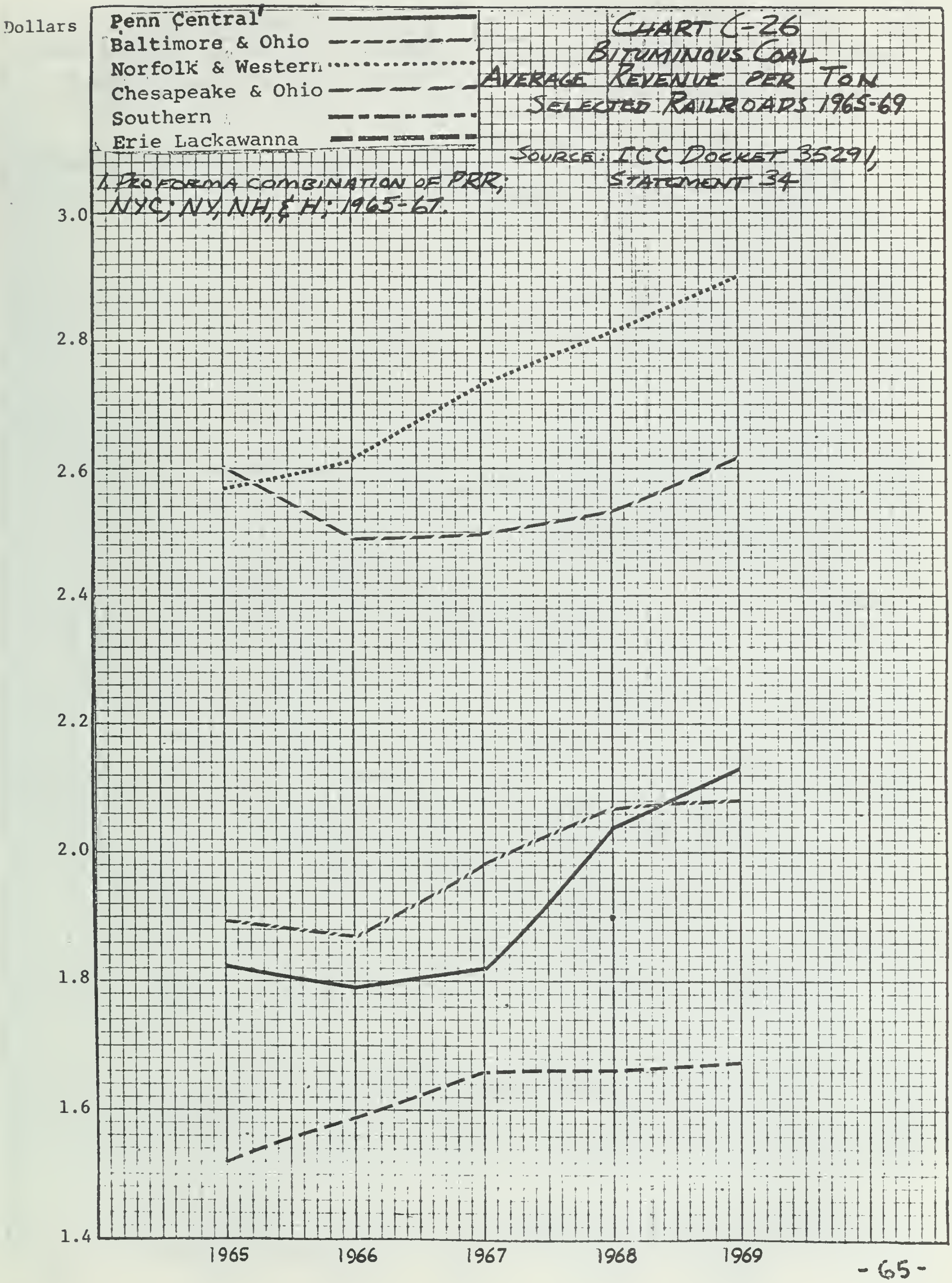
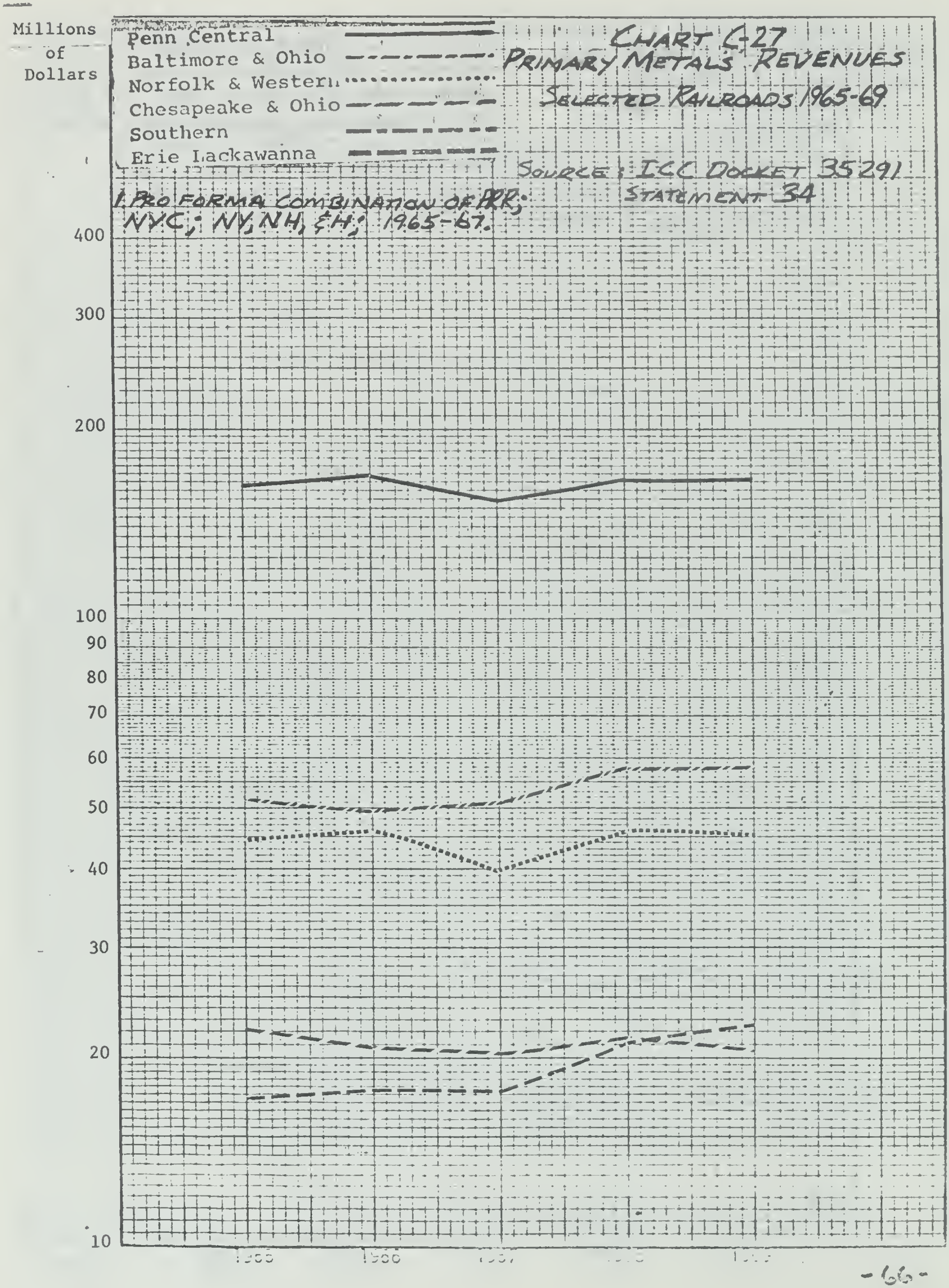


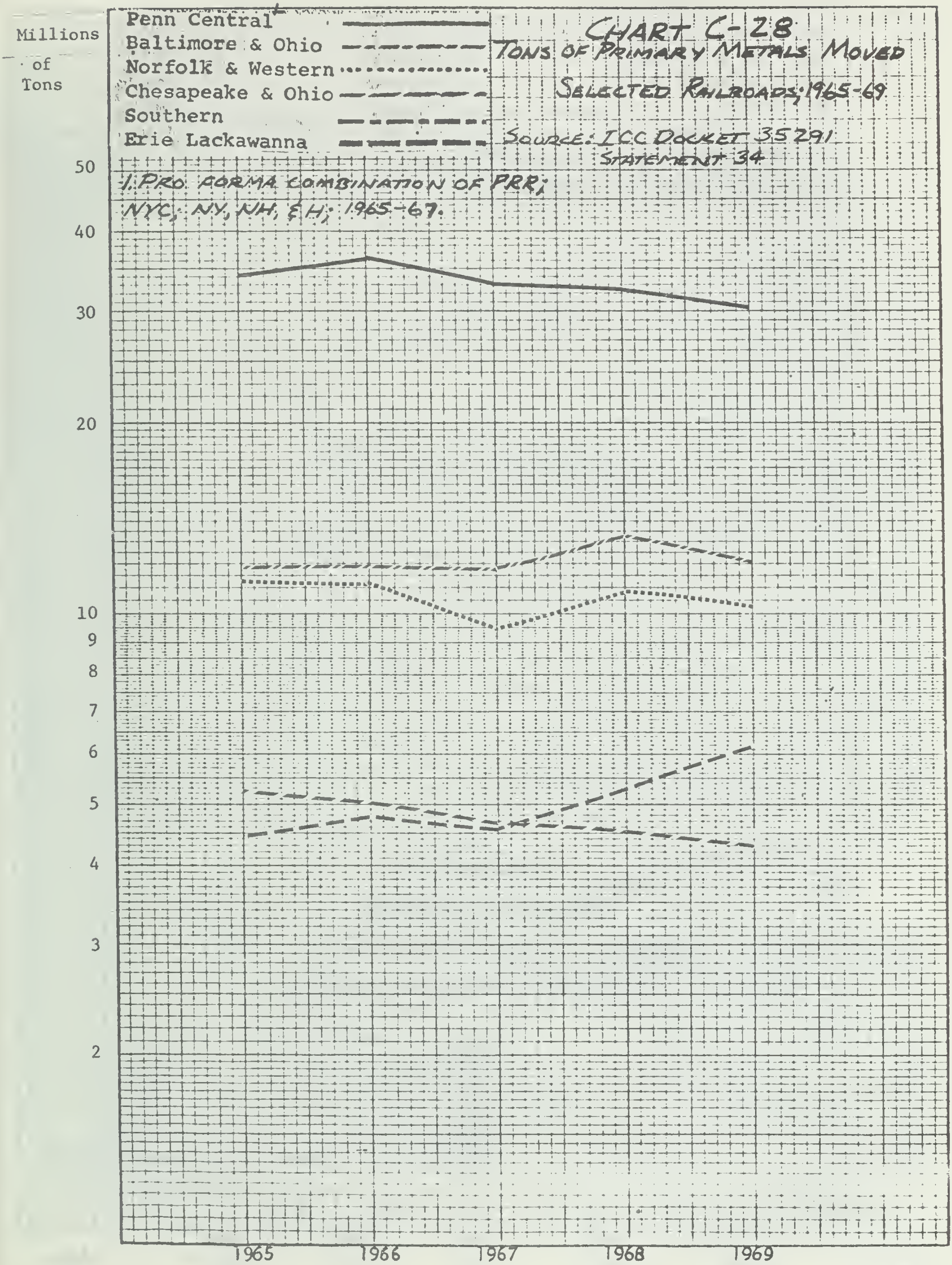
CHART C-23
TRANSPORTATION RATIO
(TRANSPORTATION EXPENSES / OPERATING REVENUE
SELECTED RAILROADS 1960-69
1 PRO FORMA COMBINATION OF PENNSYLVANIA, NEW YORK CENTRAL, AND NEW YORK, NEW HAVEN & HARTFORD; 1960-67.
SOURCE: I.C.C. DOCKET 35291 STATEMENT N934.
PC
Penn Central 1/
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
NYC
PC
PRR
50
45
40
35
30
25
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969

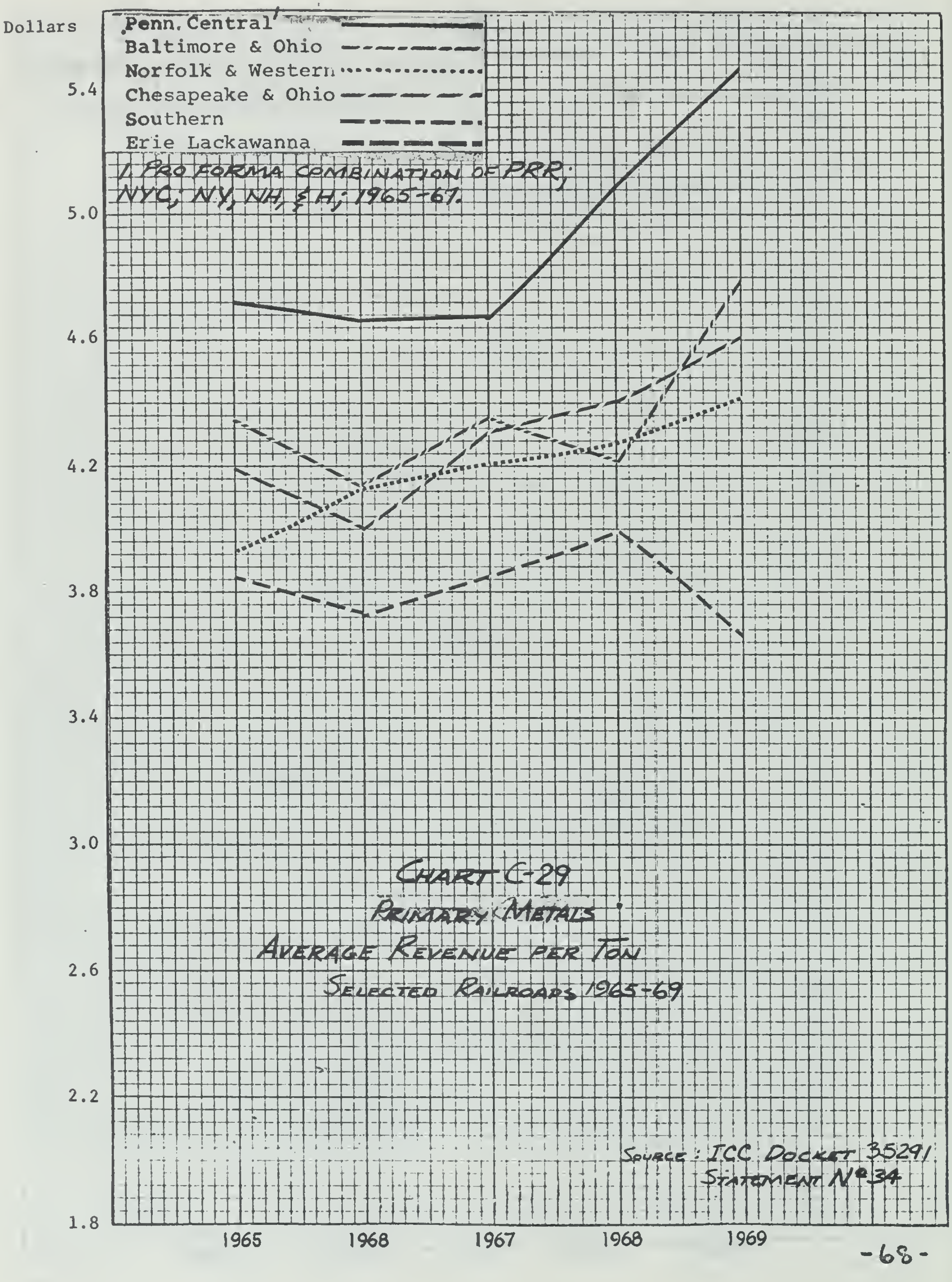

Millions of Dollars
Penn Central1
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
300
200
100
90
80
70
60
50
40
30
20
10
9
8
7
6
5
1965
1966
1967
1968
1969
CHART C-24
BITUMINOUS COAL REVENUES
EASTERN DISTRICT RAILROADS
1965 - 1969
1. PRO FORMA COMBINATION OF PRR; NYC; AND NY, NH & H; 1965-67.
SOURCE: ICC DOCKET 35291
STATEMENT 34

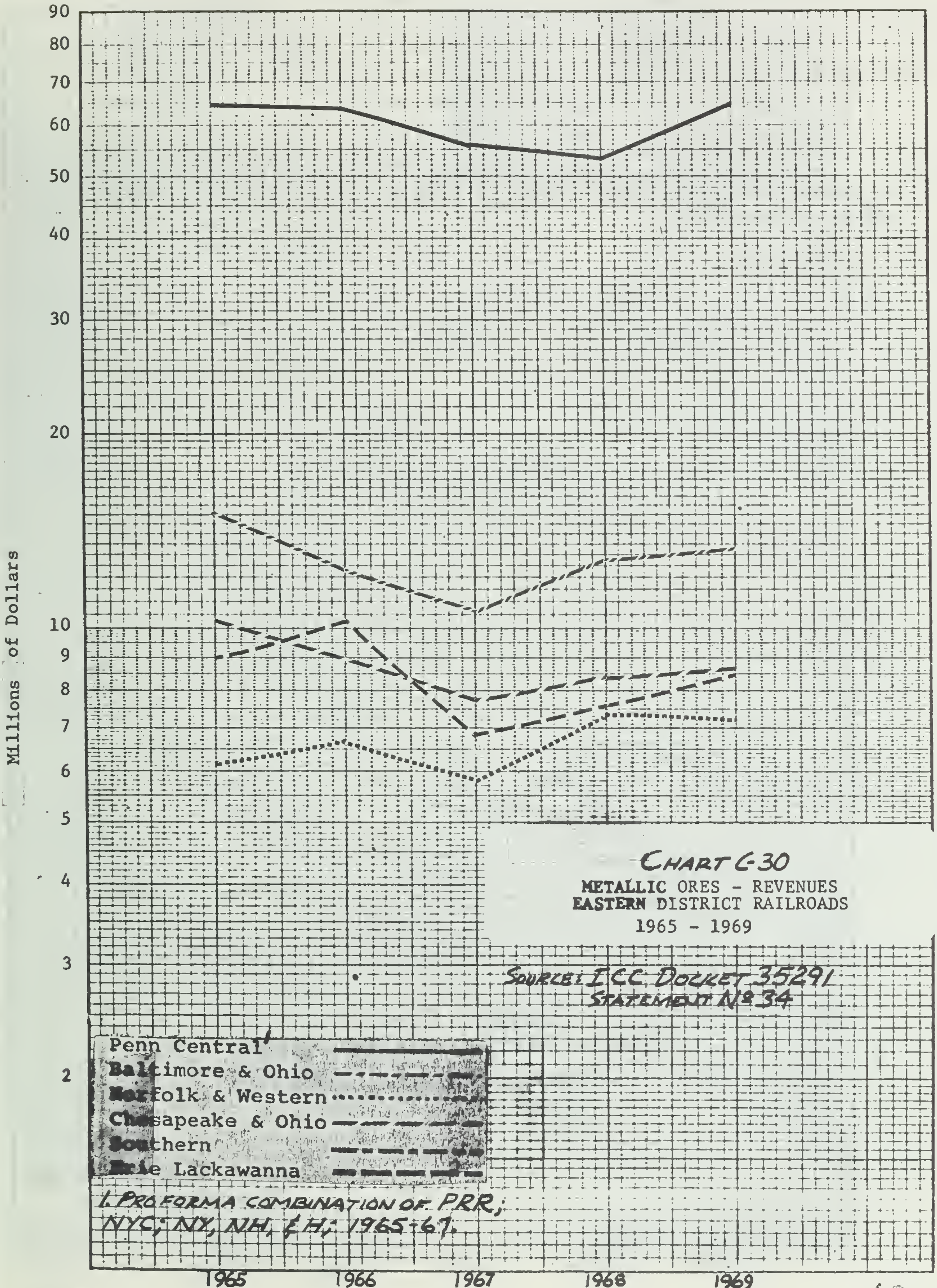

Millions of Tons
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1. PRO FORMA COMBINATION OF PRR, NYC, AND NY, NH, & H, 1965-67.
CHART C-25
TONS OF BITUMINOUS COAL MOVED SELECTED RAILROADS, 1965-69
SOURCE: ICC DOCKET 35291, STATEMENT 34.
200
100
80
60
40
20
10
8
6
5
1965
1966
1967
1968
1969

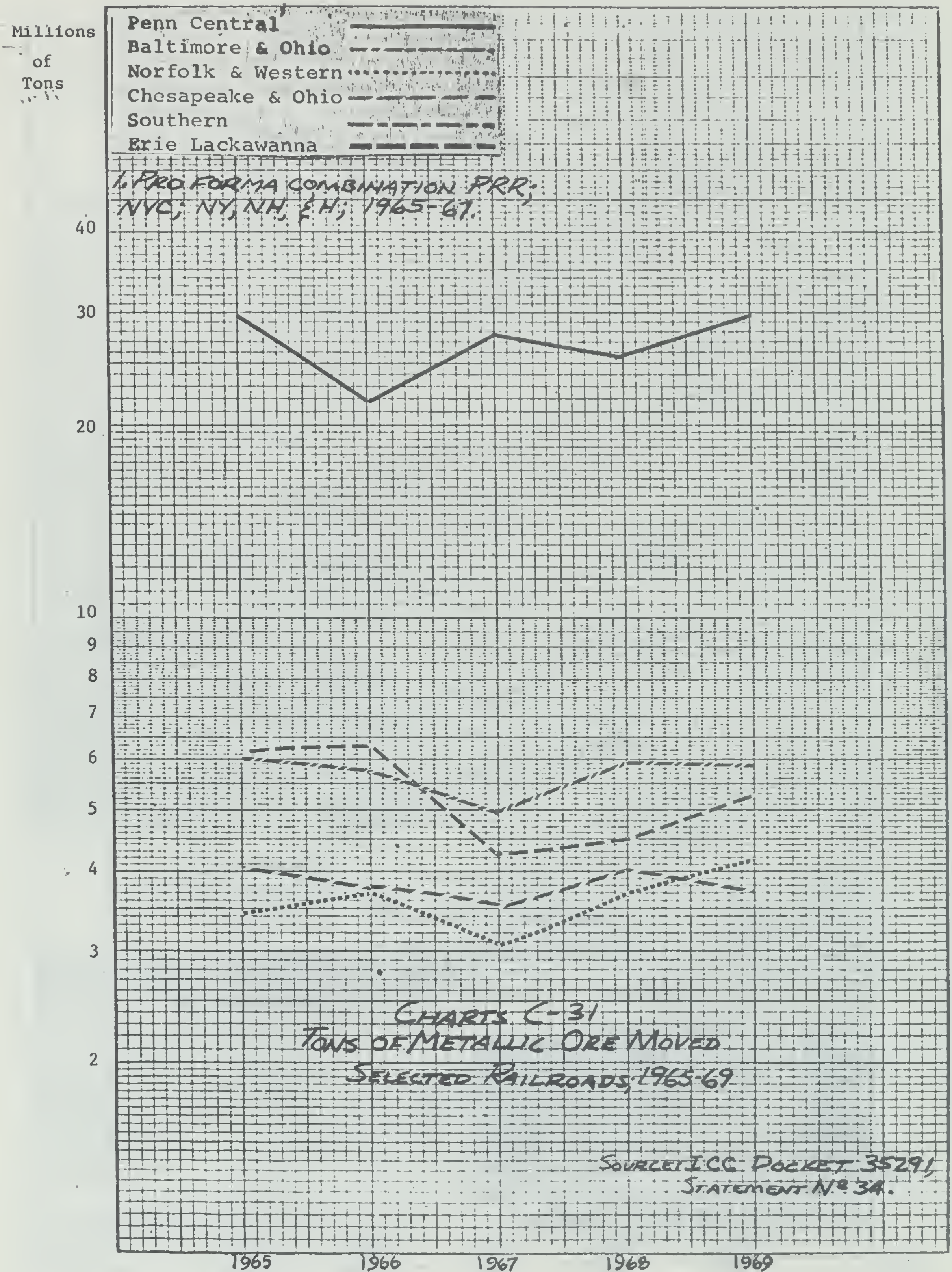

Dollars
Penn Central'
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-26
BITUMINOUS COAL
AVERAGE REVENUE PER TON
SELECTED RAILROADS 1965-69
SOURCE: ICC DOCKET 35291,
STATEMENT 34
1. PRO FORMA COMBINATION OF PRR, NYC, NY, NH, & H; 1965-67.
3.0
2.8
2.6
2.4
2.2
2.0
1.8
1.6
1.4
1965
1966
1967
1968
1969


Millions
of
Dollars
Penn Central
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-27
PRIMARY METALS REVENUES
SELECTED RAILROADS 1965-69
SOURCE: ICC DOCKET 35291
STATEMENT 34
1 PRO FORMA COMBINATION OF PRR; NYC; NY, NH, & H; 1965-67.
400
300
200
100
90
80
70
60
50
40
30
20
10

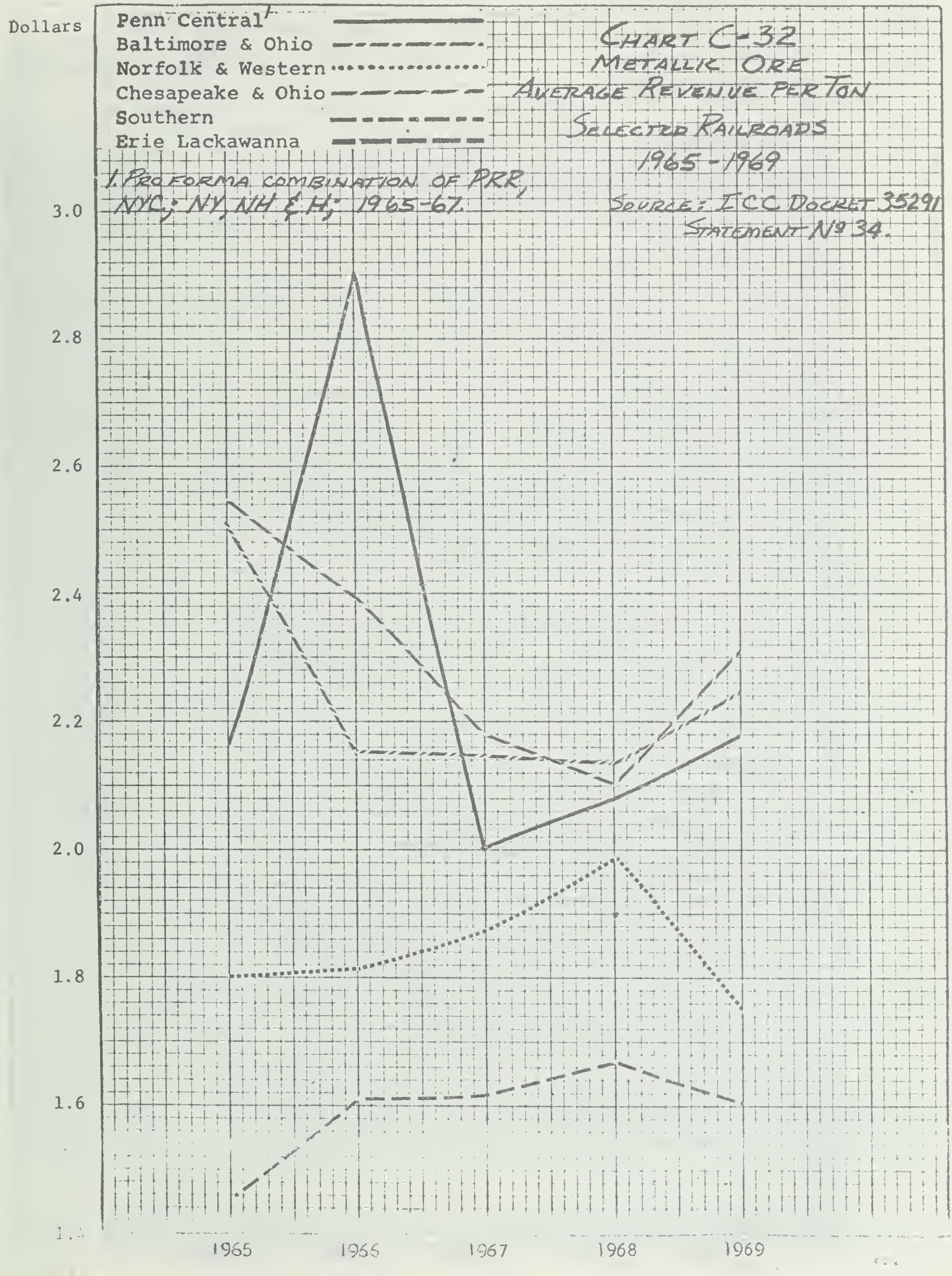

Millions of Tons
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-28
TONS OF PRIMARY METALS MOVED
SELECTED RAILROADS, 1965-69
SOURCE: ICC DOCKET 35291
STATEMENT 34
1. PRO FORMA COMBINATION OF PRR, NYC, NY, NH, & H; 1965-67.
50
40
30
20
10
9
8
7
6
5
4
3
2
1965
1966
1967
1968
1969

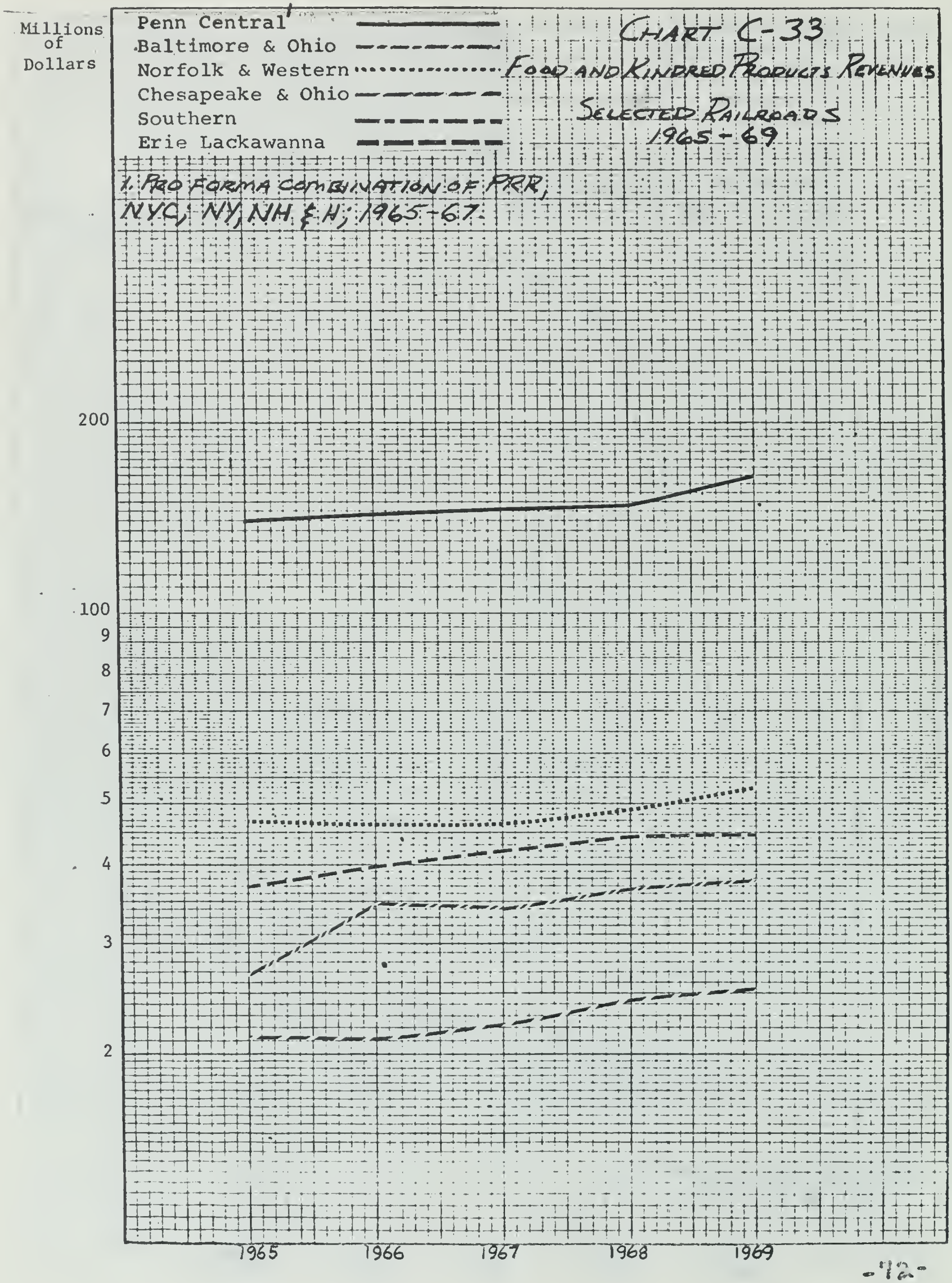

Dollars
Penn. Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1. Pro forma combination of PRR, NYC, NY, NH, & H; 1965-67.
5.4
5.0
4.6
4.2
3.8
3.4
3.0
2.6
2.2
1.8
1965
1968
1967
1968
1969
Chart C-29
Primary Metals
Average Revenue per Ton
Selected Railroads 1965-69
Source: ICC Docket 35291
Statement No 34

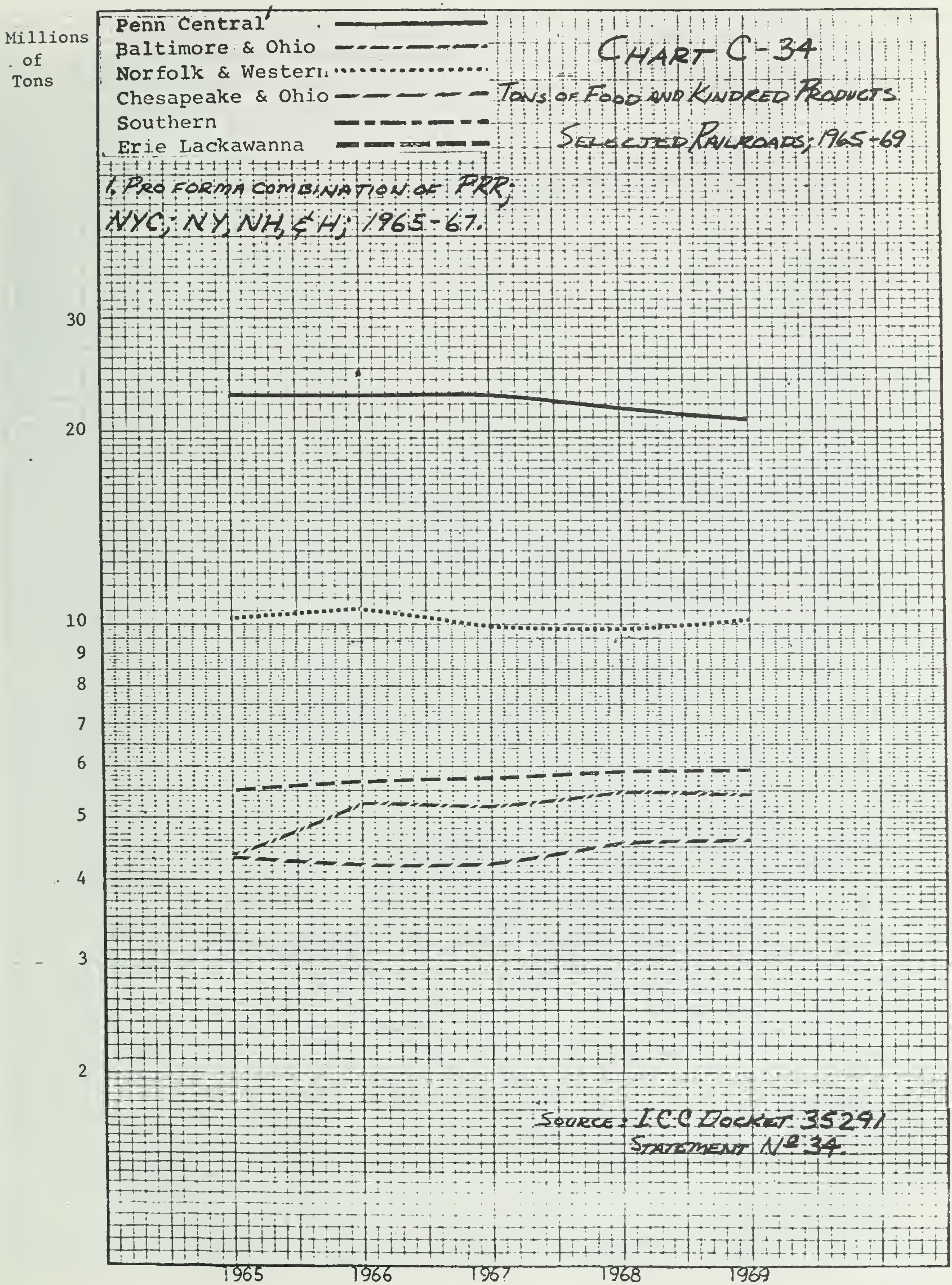

90
80
70
60
50
40
30
20
10
9
8
7
6
5
4
3
2
Millions of Dollars
CHART C-30
METALLIC ORES - REVENUES
EASTERN DISTRICT RAILROADS
1965 - 1969
SOURCE: I.C.C. DOCKET 35291
STATEMENT № 34
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1. PRO FORMA COMBINATION OF PRR; NYC; NY, NH, & H; 1965-67.
1965
1966
1967
1968
1969



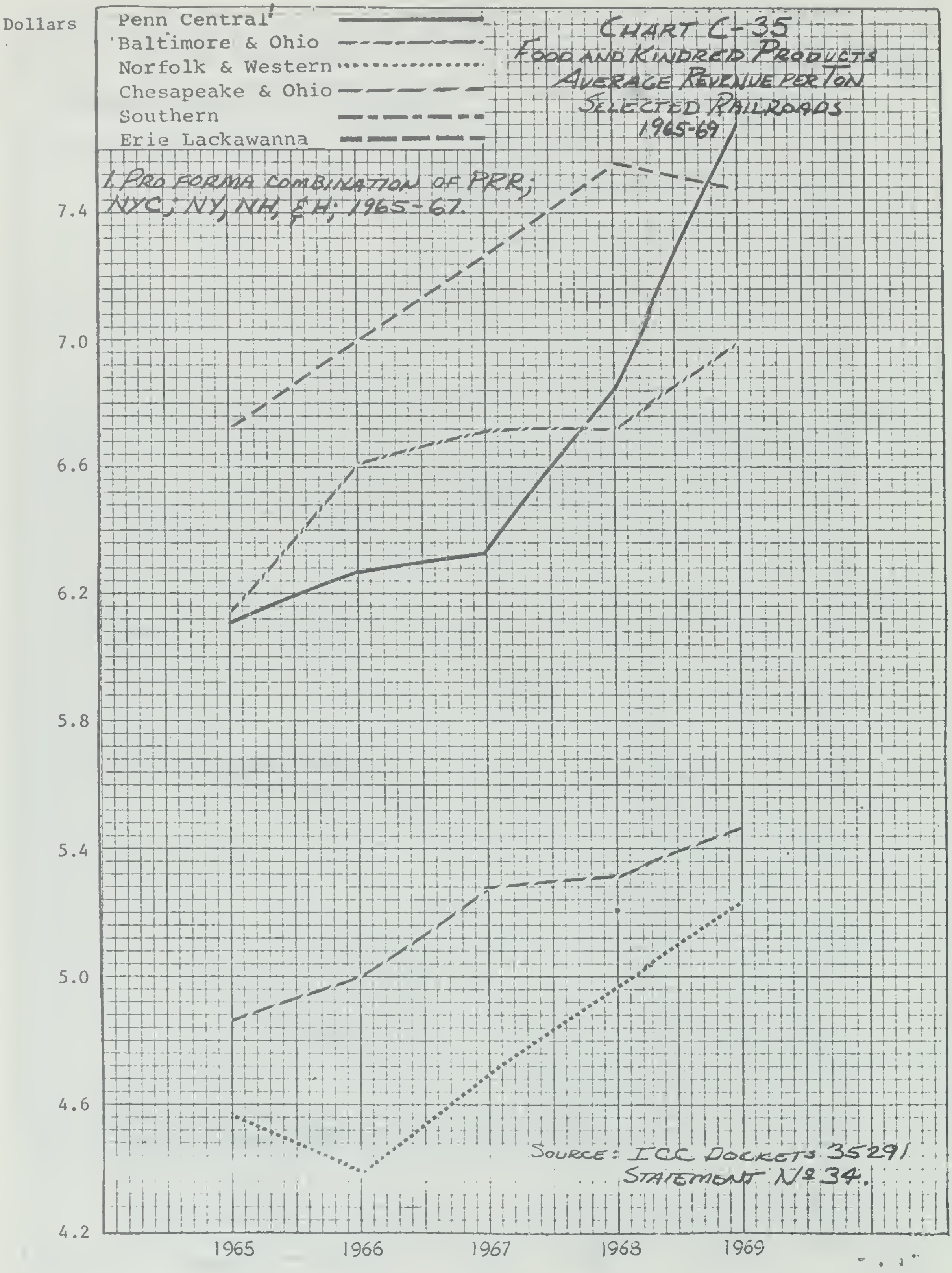
Charts C-31
Tons of Metallic Ore Moved
Selected Railroads, 1965-69

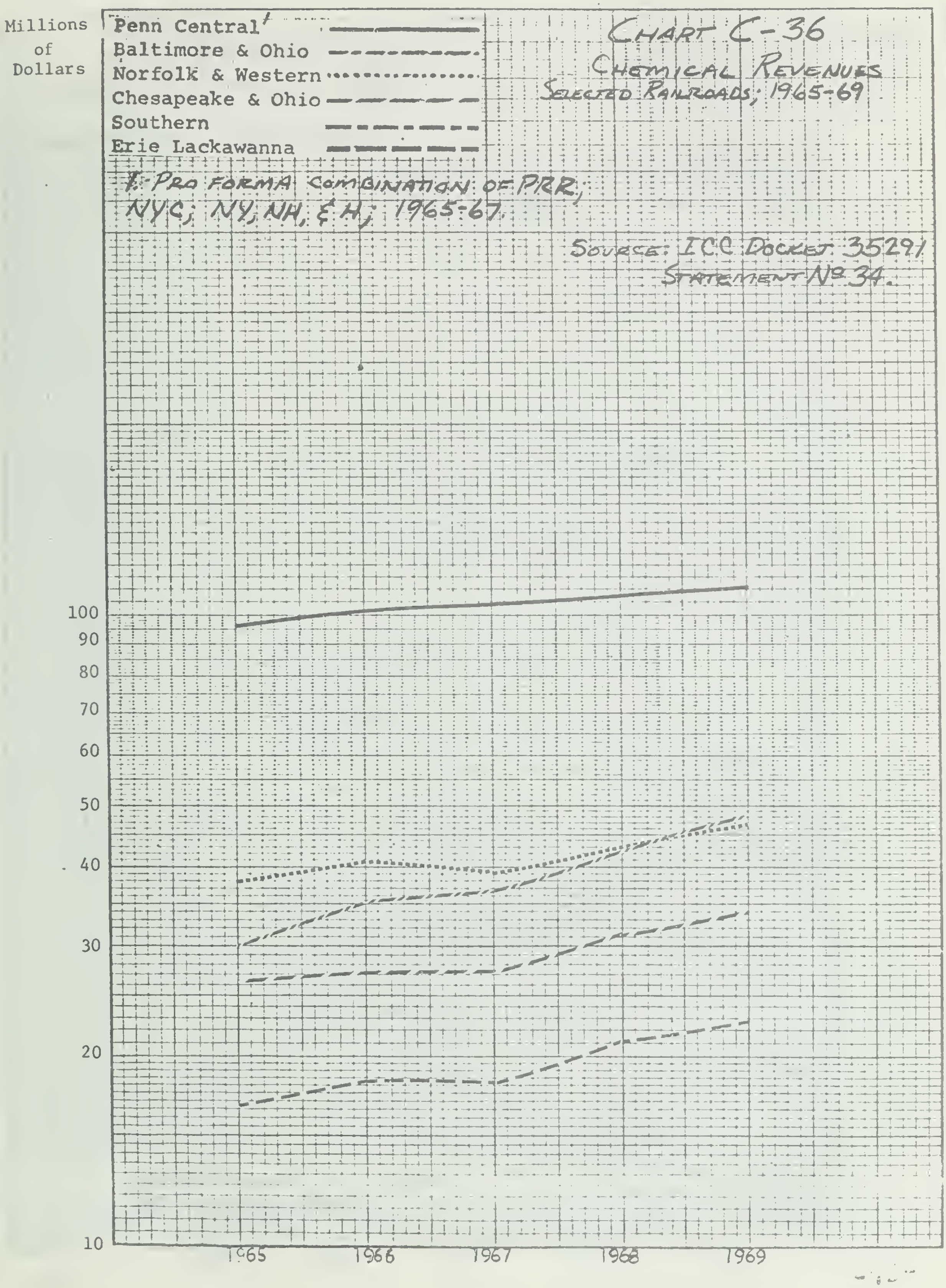

Dollars
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-32
METALLIC ORE
AVERAGE REVENUE PER TON
SELECTED RAILROADS
1965 - 1969
1. PROFORMA COMBINATION OF PRR, NYC; NY, NH & H; 1965-67.
SOURCE: ICC DOCKET 35291
STATEMENT Nº 34.
3.0
2.8
2.6
2.4
2.2
2.0
1.8
1.6
1965
1966
1967
1968
1969

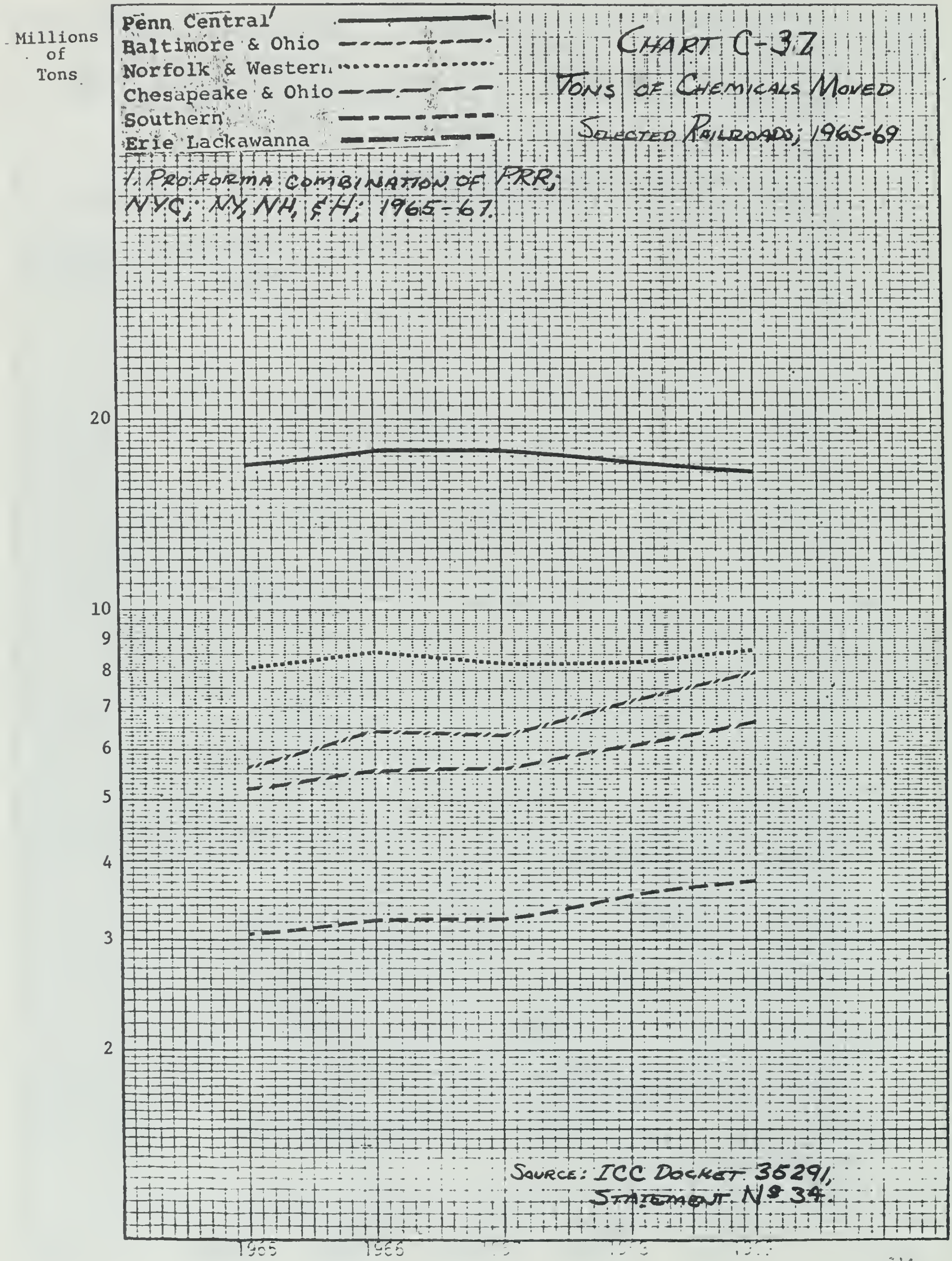

Millions of Dollars
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-33
FOOD AND KINDRED PRODUCTS REVENUES
SELECTED RAILROADS
1965 - 69
1. PRO FORMA COMBINATION OF PRR, NYC, NY, NH & H; 1965-67.
200
100
9
8
7
6
5
4
3
2
1965
1966
1967
1968
1969

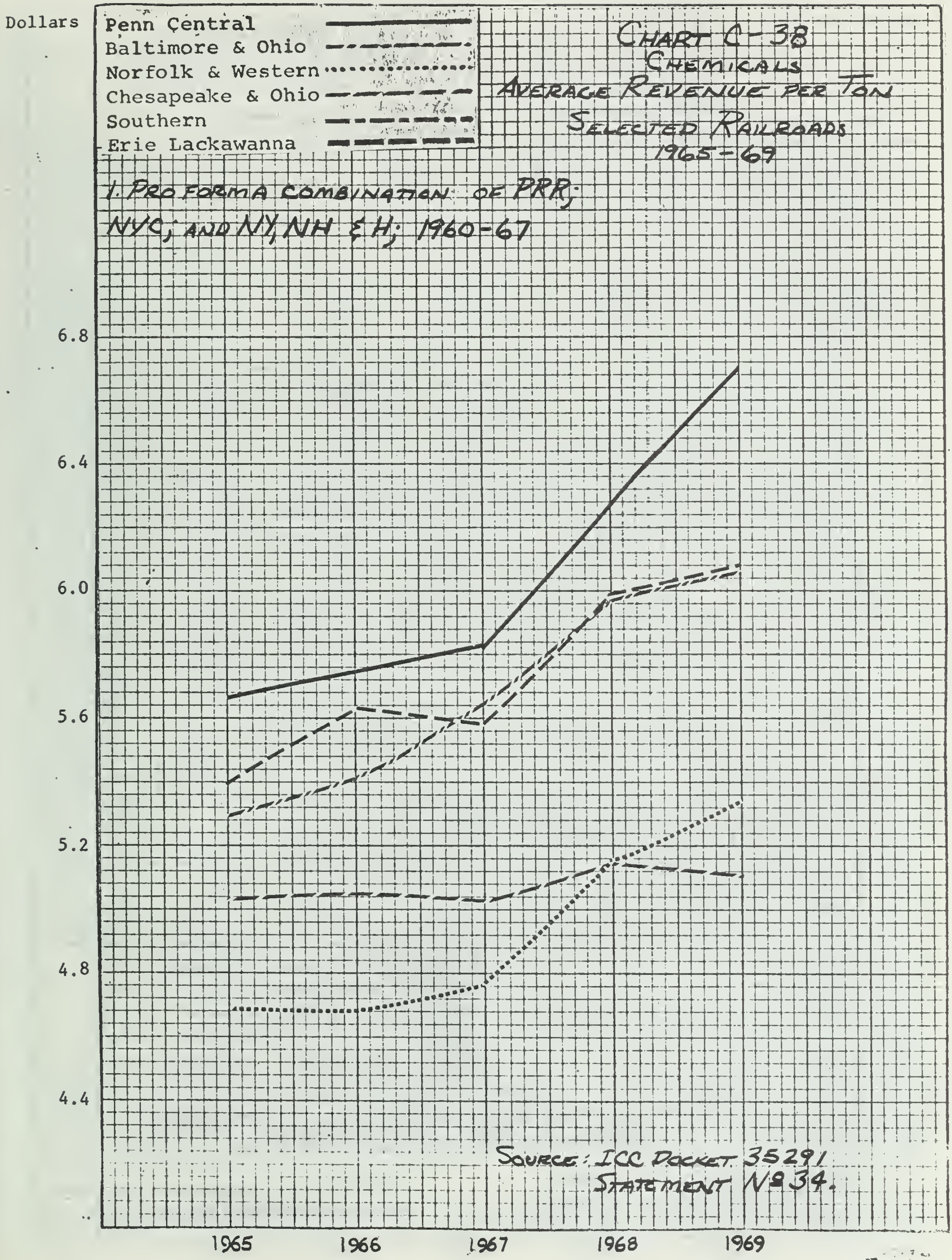


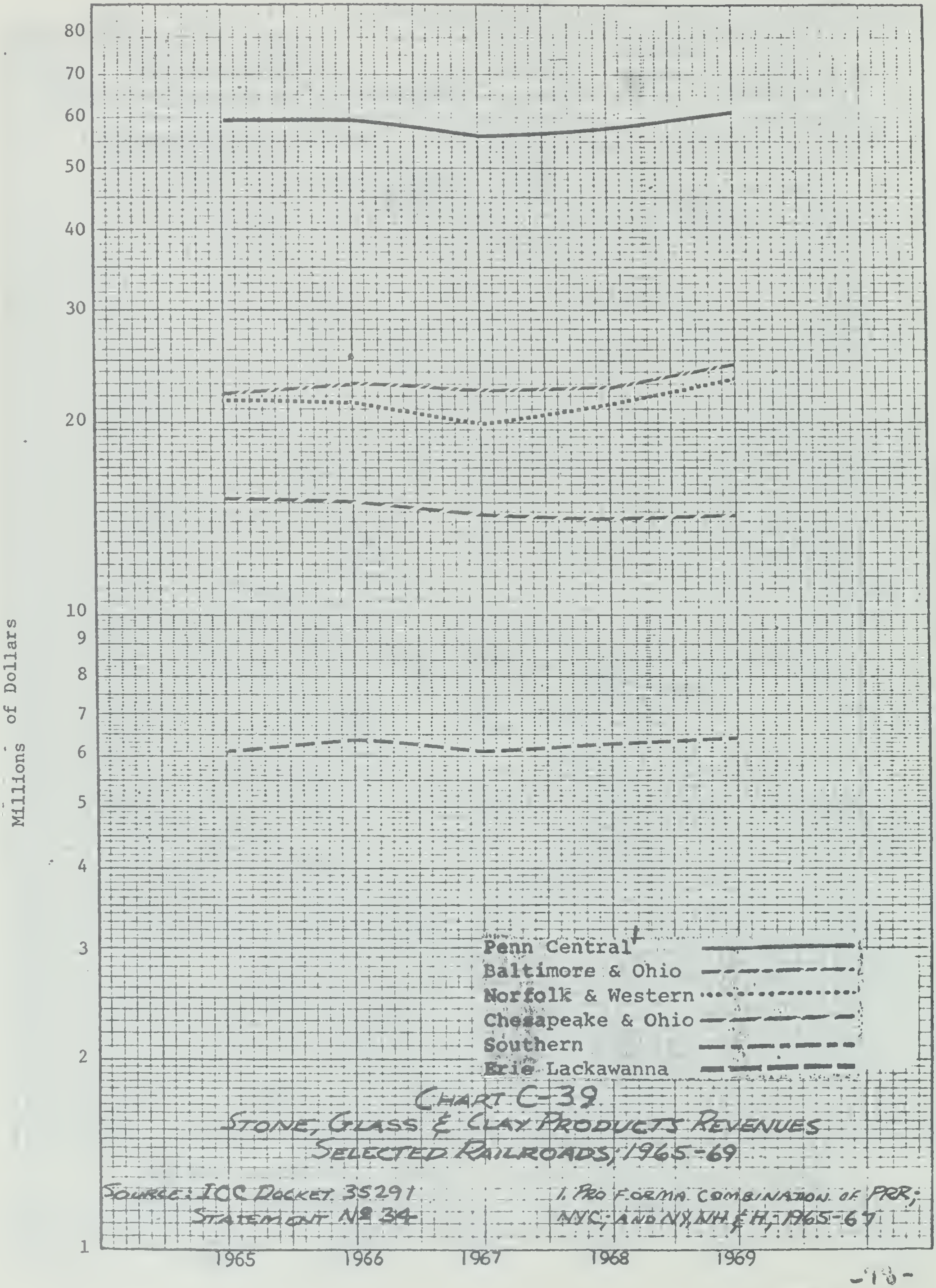
Millions of Tons
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-34
TONS OF FOOD AND KINDRED PRODUCTS
SELECTED RAILROADS; 1965-69
1. PRO FORMA COMBINATION OF PRR; NYC; NY, NH, & H; 1965-67.
30
20
10
9
8
7
6
5
4
3
2
SOURCE: I.C.C. DOCKET 35291
STATEMENT Nº 34.
1965
1966
1967
1968
1969


Dollars
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-35
FOOD AND KINDRED PRODUCTS
AVERAGE REVENUE PER TON
SELECTED RAILROADS
1965-69
1. PRO FORMA COMBINATION OF PRR; NYC; NY, NH, & H; 1965-67.
7.4
7.0
6.6
6.2
5.8
5.4
5.0
4.6
4.2
1965
1966
1967
1968
1969
SOURCE: ICC DOCKETS 35291
STATEMENT Nº 34.


Millions
of
Dollars
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-36
CHEMICAL REVENUES
SELECTED RAILROADS; 1965-69
1 - PRO FORMA COMBINATION OF PRR,
NYC, NY, NH, & H; 1965-67.
SOURCE: ICC DOCKET 35291
STATEMENT Nº 34.
100
90
80
70
60
50
40
30
20
10
1965
1966
1967
1968
1969


Millions of Tons
Penn Central/
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-37
TONS OF CHEMICALS MOVED
SELECTED RAILROADS; 1965-69
/. PRO FORMA COMBINATION OF PRR; NYC; NY, NH, & H; 1965-67.
20
10
9
8
7
6
5
4
3
2
SOURCE: ICC DOCKET 35291, STATEMENT No 34.
1965
1966


Dollars
Penn Central
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
CHART C-38
CHEMICALS
AVERAGE REVENUE PER TON
SELECTED RAILROADS
1965-69
1. PRO FORMA COMBINATION OF PRR; NYC; AND NY, NH & H; 1960-67
6.8
6.4
6.0
5.6
5.2
4.8
4.4
SOURCE: ICC DOCKET 35291
STATEMENT № 34.
1965
1966
1967
1968
1969


80
70
60
50
40
30
20
10
9
8
7
6
5
4
3
2
1
Millions of Dollars
1965
1966
1967
1968
1969
Penn Central 1
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
Chart C-39
Stone, Glass & Clay Products Revenues
Selected Railroads, 1965-69
Source: ICC Docket 35291
Statement Nº 34
1. Pro Forma Combination of PRR; NYC, and NY,NH & H; 1965-67

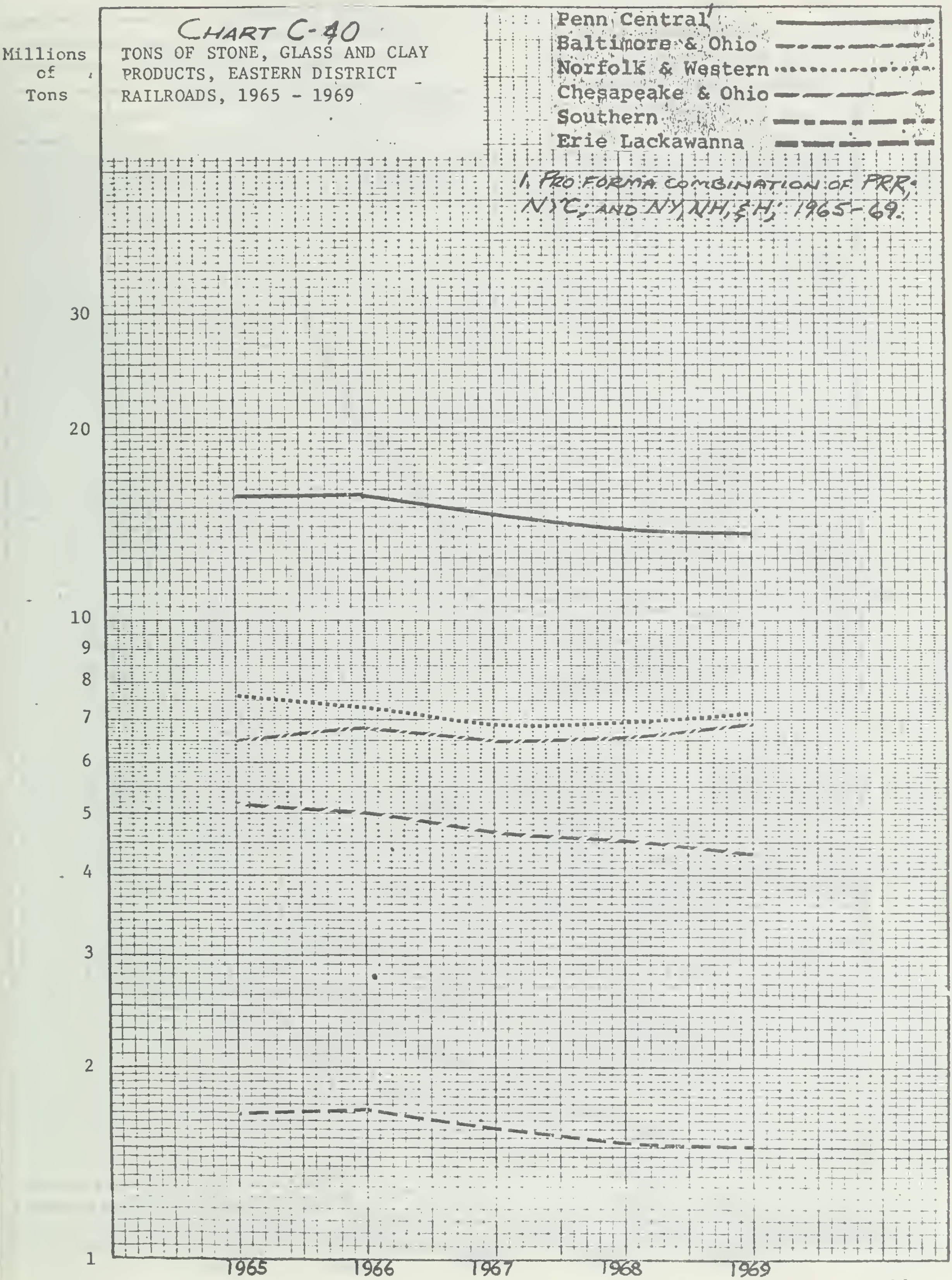


CHART C-40
TONS OF STONE, GLASS AND CLAY PRODUCTS, EASTERN DISTRICT RAILROADS, 1965 - 1969
Millions of Tons
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1. PRO FORMA COMBINATION OF PRR, NYC, AND NY,NH,&H, 1965-69.
30
20
10
9
8
7
6
5
4
3
2
1
1965
1966
1967
1968
1969

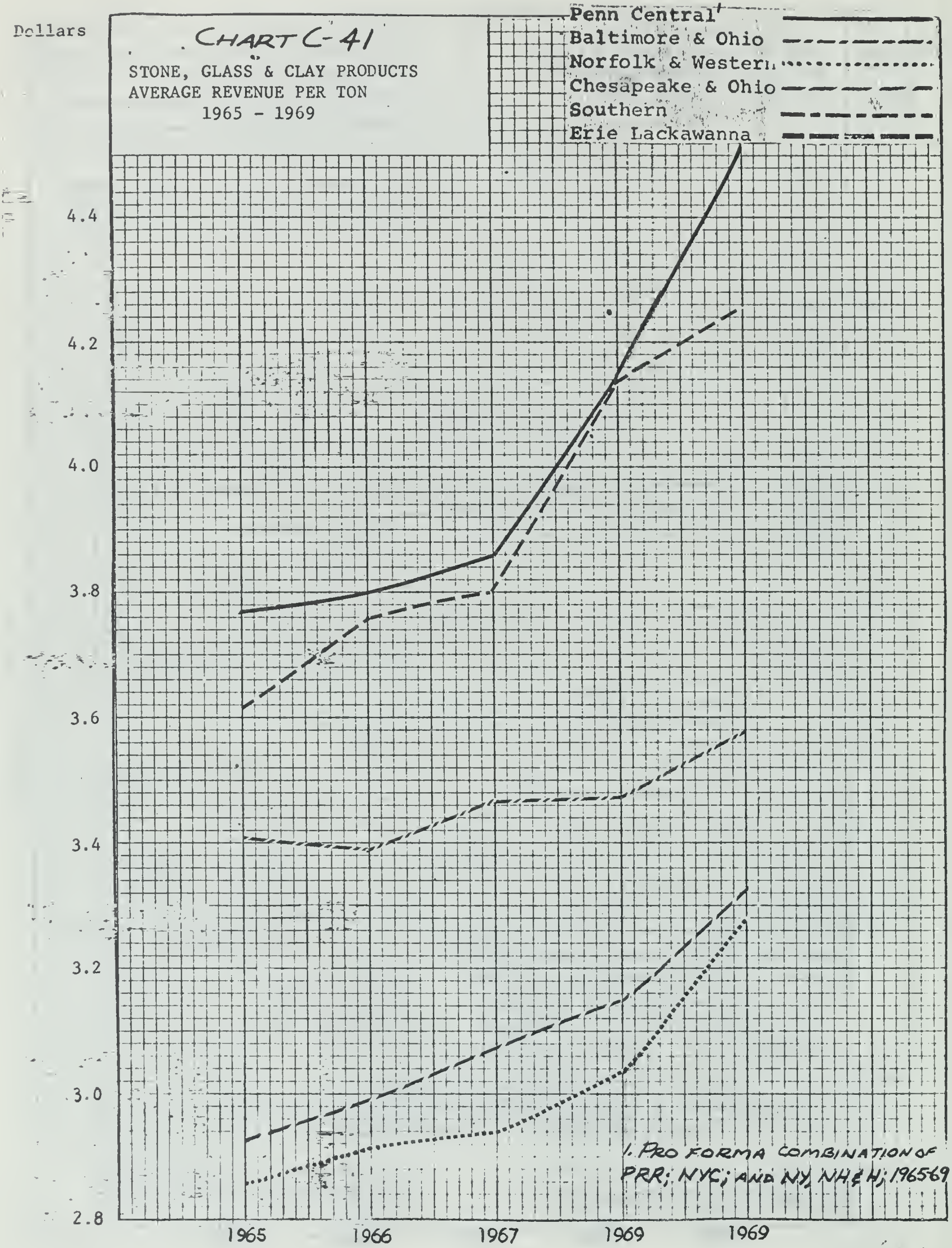
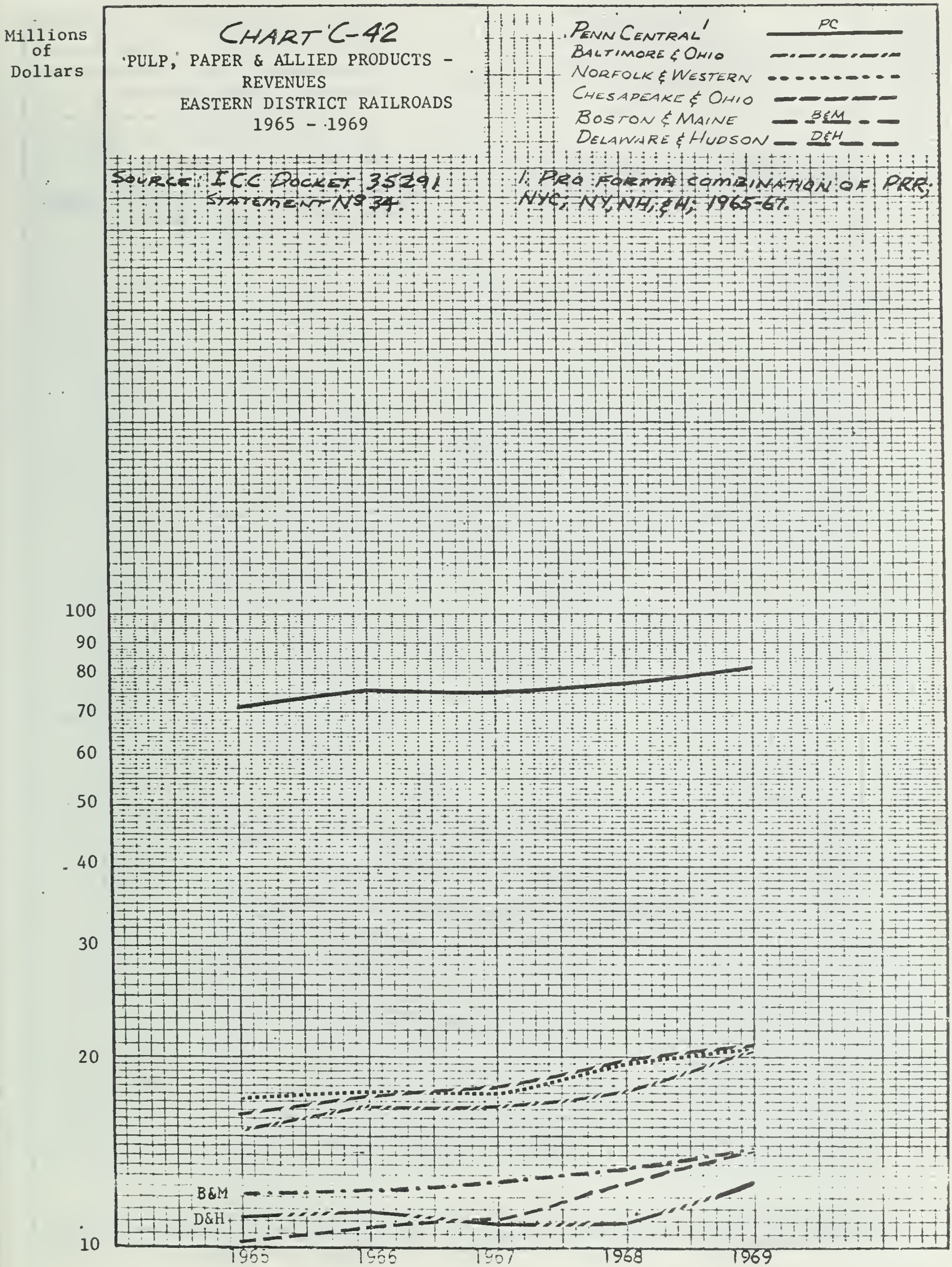
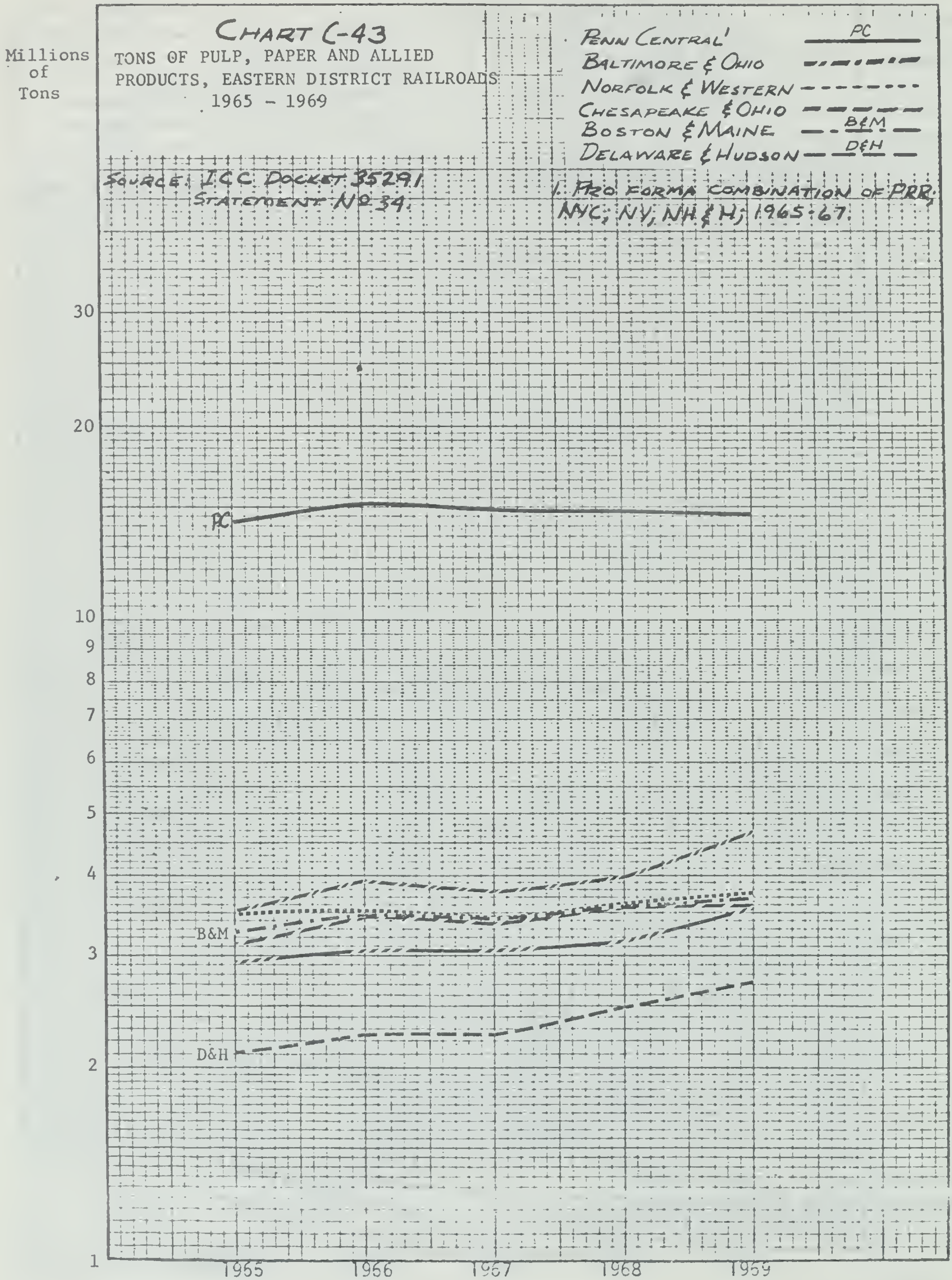
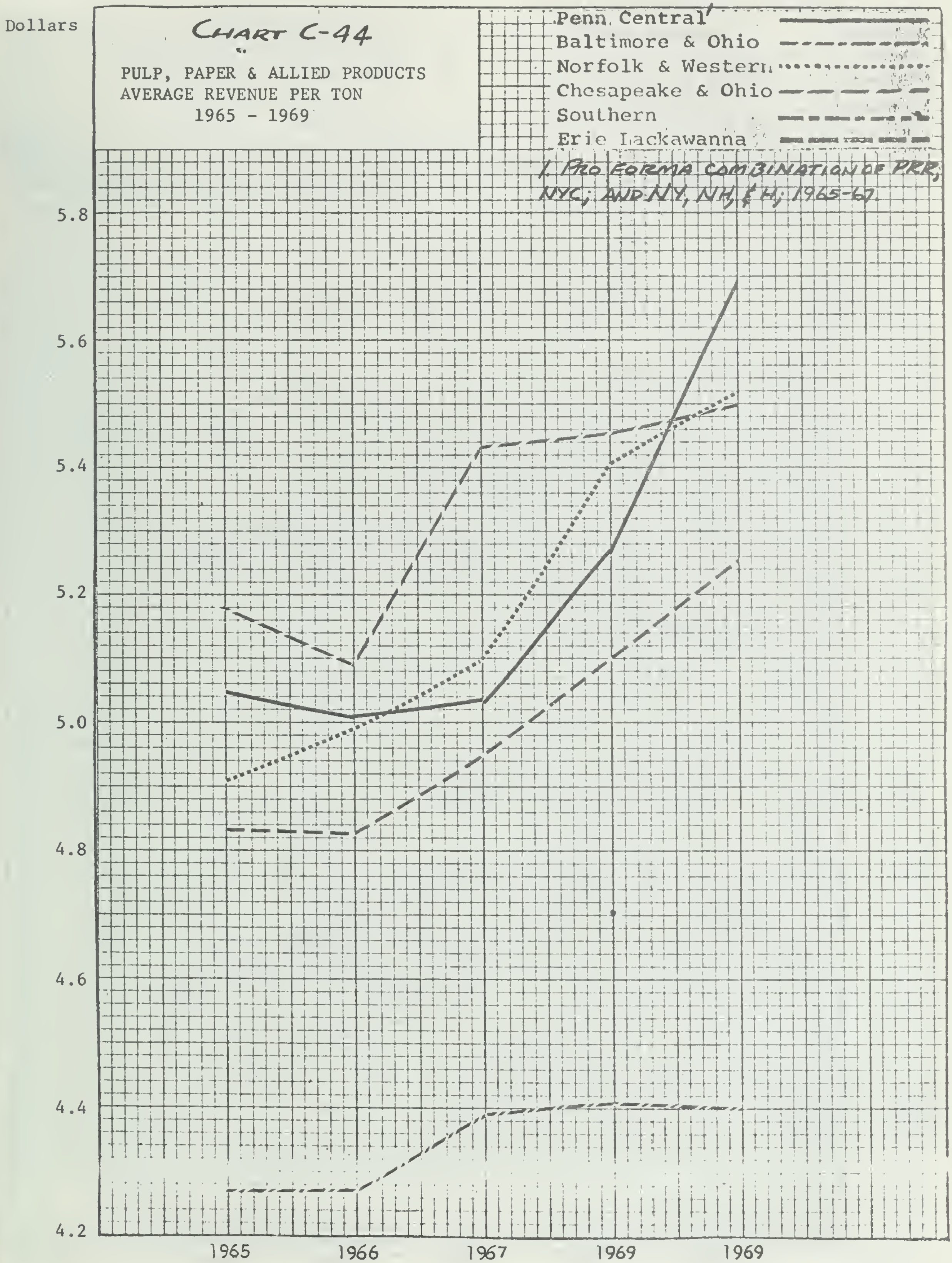


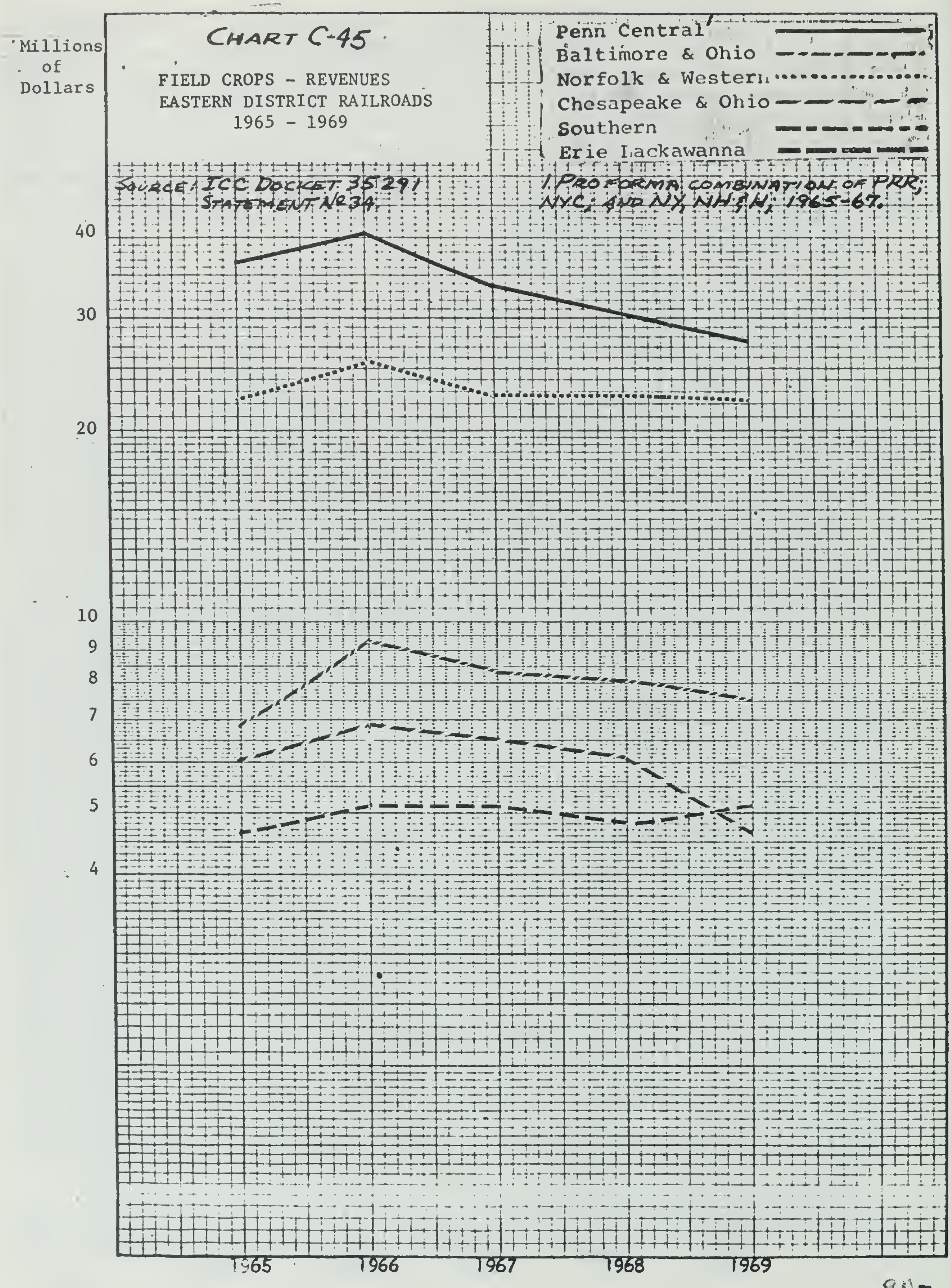
CHART C-41
STONE, GLASS & CLAY PRODUCTS
AVERAGE REVENUE PER TON
1965 - 1969
Dollars
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
4.4
4.2
4.0
3.8
3.6
3.4
3.2
3.0
2.8
1965
1966
1967
1969
1969
1. PRO FORMA COMBINATION OF
PRR; NYC; AND NY, NH & H; 1965-69

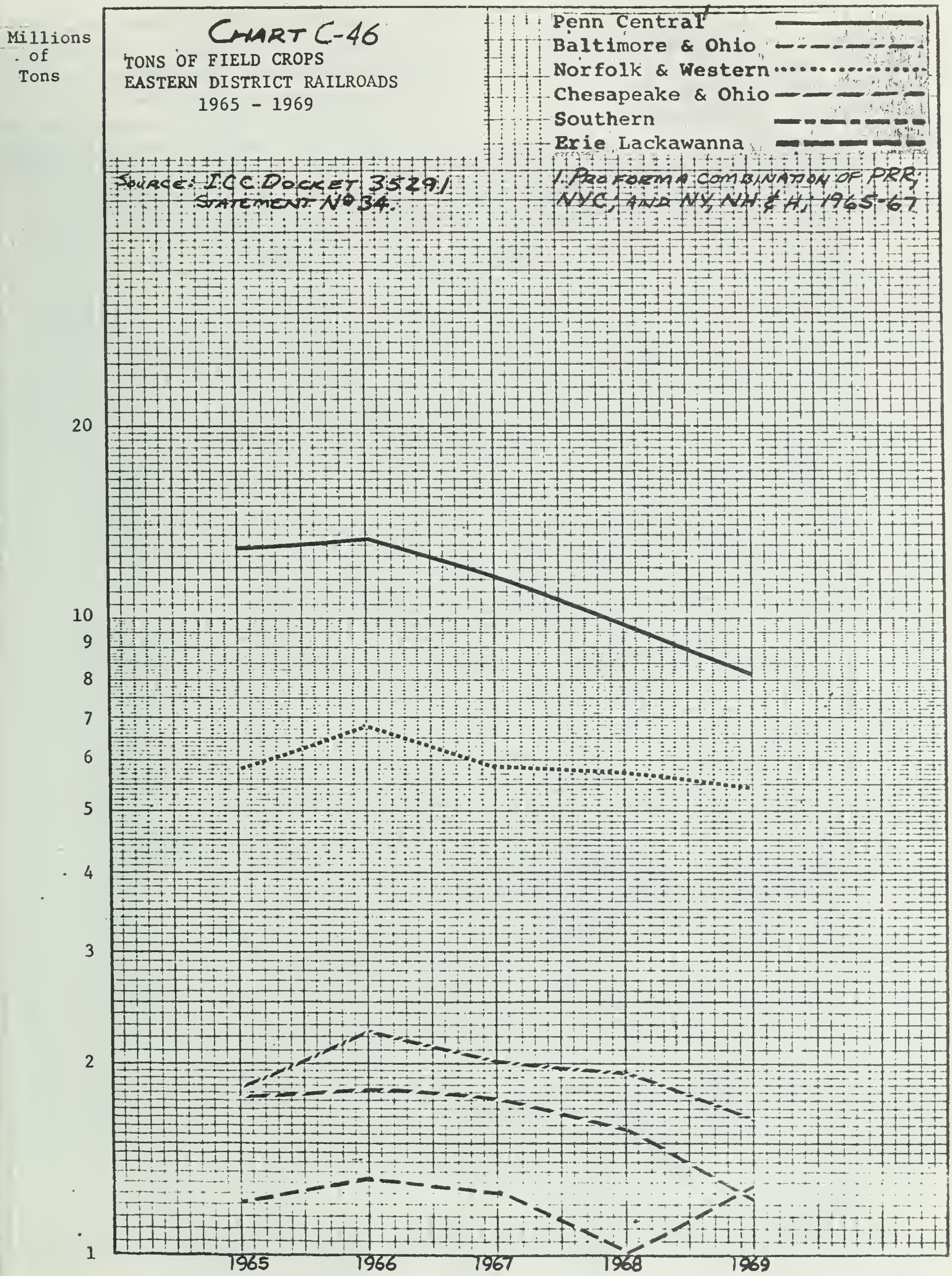

Millions of Dollars
CHART C-42
PULP, PAPER & ALLIED PRODUCTS - REVENUES
EASTERN DISTRICT RAILROADS
1965 - 1969
PENN CENTRAL[1] PC
BALTIMORE & OHIO
NORFOLK & WESTERN
CHESAPEAKE & OHIO
BOSTON & MAINE B&M
DELAWARE & HUDSON D&H
SOURCE: ICC DOCKET 35291
STATEMENT Nº 34.
1. PRO FORMA COMBINATION OF PRR; NYC; NY,NH,&H; 1965-67.
100
90
80
70
60
50
40
30
20
10
B&M
D&H
1965
1966
1967
1968
1969



Millions of Tons
CHART C-43
TONS OF PULP, PAPER AND ALLIED PRODUCTS, EASTERN DISTRICT RAILROADS
1965 - 1969
PENN CENTRAL[1] PC
BALTIMORE & OHIO
NORFOLK & WESTERN
CHESAPEAKE & OHIO
BOSTON & MAINE B&M
DELAWARE & HUDSON D&H
SOURCE: I.C.C. DOCKET 35291
STATEMENT No 34.
1. PRO FORMA COMBINATION OF PRR, NYC, NY, NH & H; 1965-67.
30
20
10
9
8
7
6
5
4
3
2
1
PC
B&M
D&H
1965
1966
1967
1968
1969


Dollars
CHART C-44
PULP, PAPER & ALLIED PRODUCTS
AVERAGE REVENUE PER TON
1965 - 1969
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1 PRO FORMA COMBINATION OF PRR, NYC, AND NY, NH, & H; 1965-67.
5.8
5.6
5.4
5.2
5.0
4.8
4.6
4.4
4.2
1965
1966
1967
1969
1969


Millions of Dollars
CHART C-45
FIELD CROPS - REVENUES
EASTERN DISTRICT RAILROADS
1965 - 1969
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
Source: ICC Docket 35291
Statement No 34.
1. Pro forma combination of PRR; NYC; and NY, NH & H; 1965-67.
40
30
20
10
9
8
7
6
5
4
1965
1966
1967
1968
1969


Millions of Tons
CHART C-46
TONS OF FIELD CROPS
EASTERN DISTRICT RAILROADS
1965 - 1969
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
Source: I.C.C. Docket 35291
Statement Nº 34.
1. Pro forma combination of PRR, NYC, and NY, NH & H, 1965-67
20
10
9
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5
4
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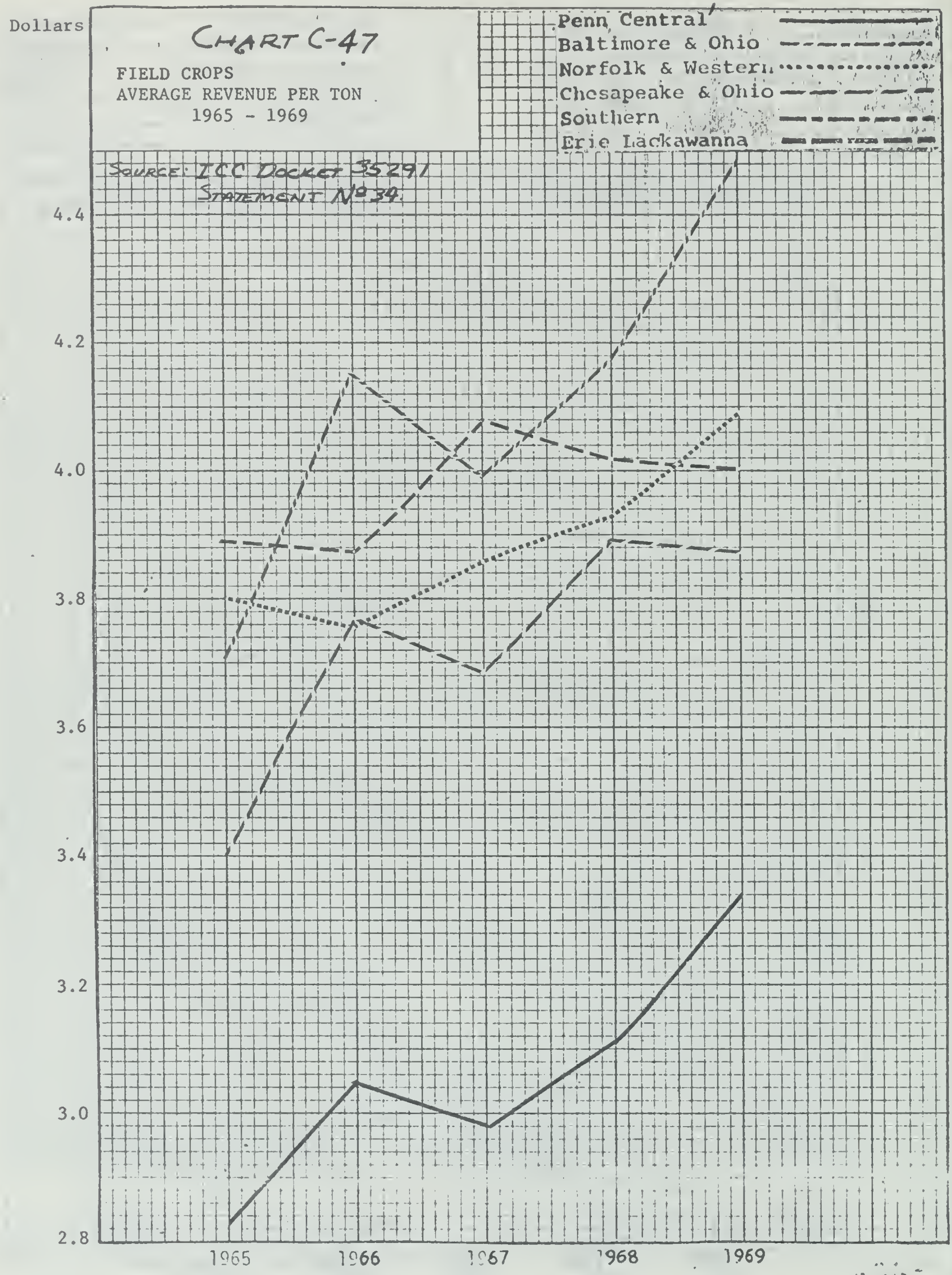
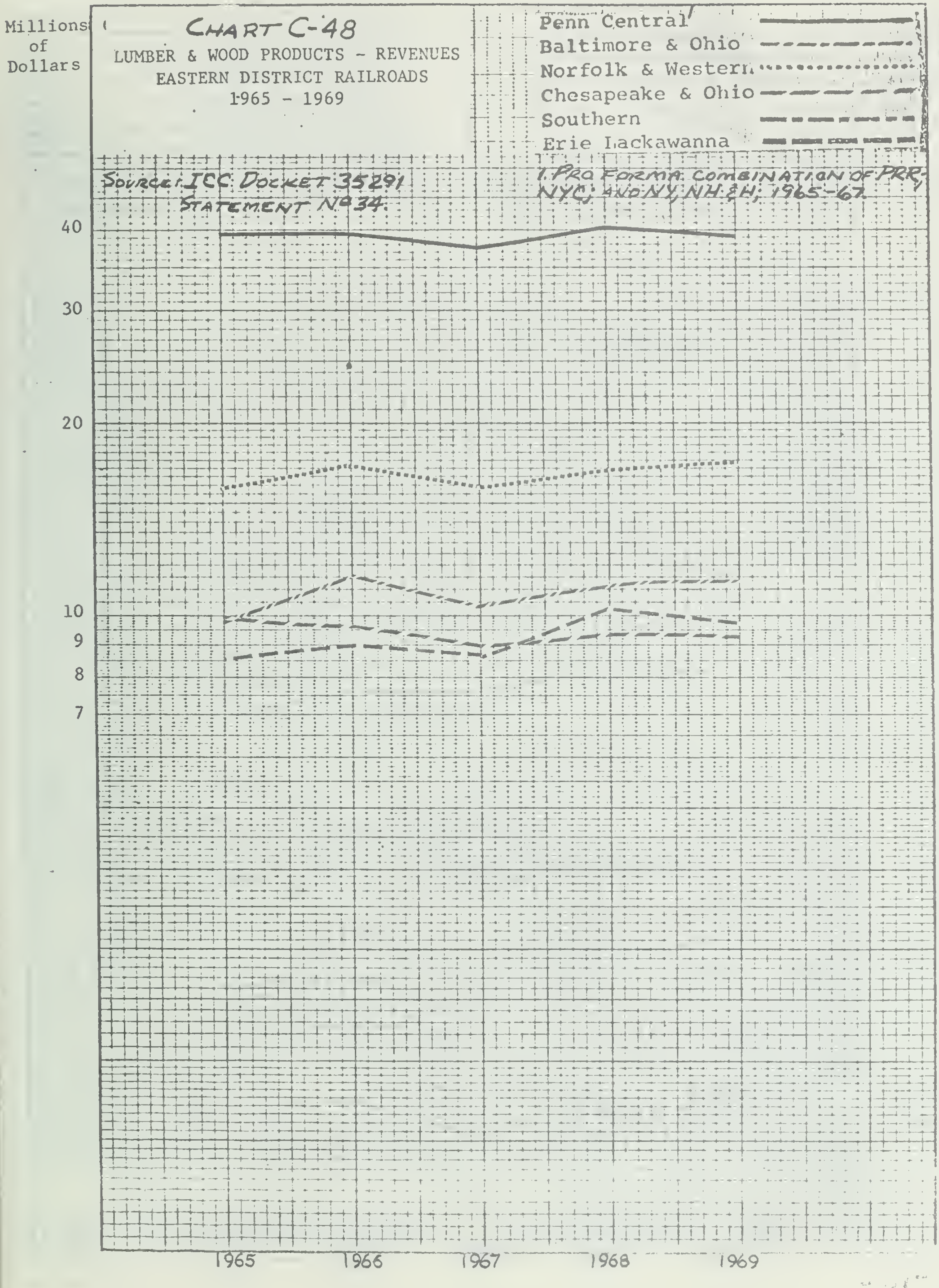
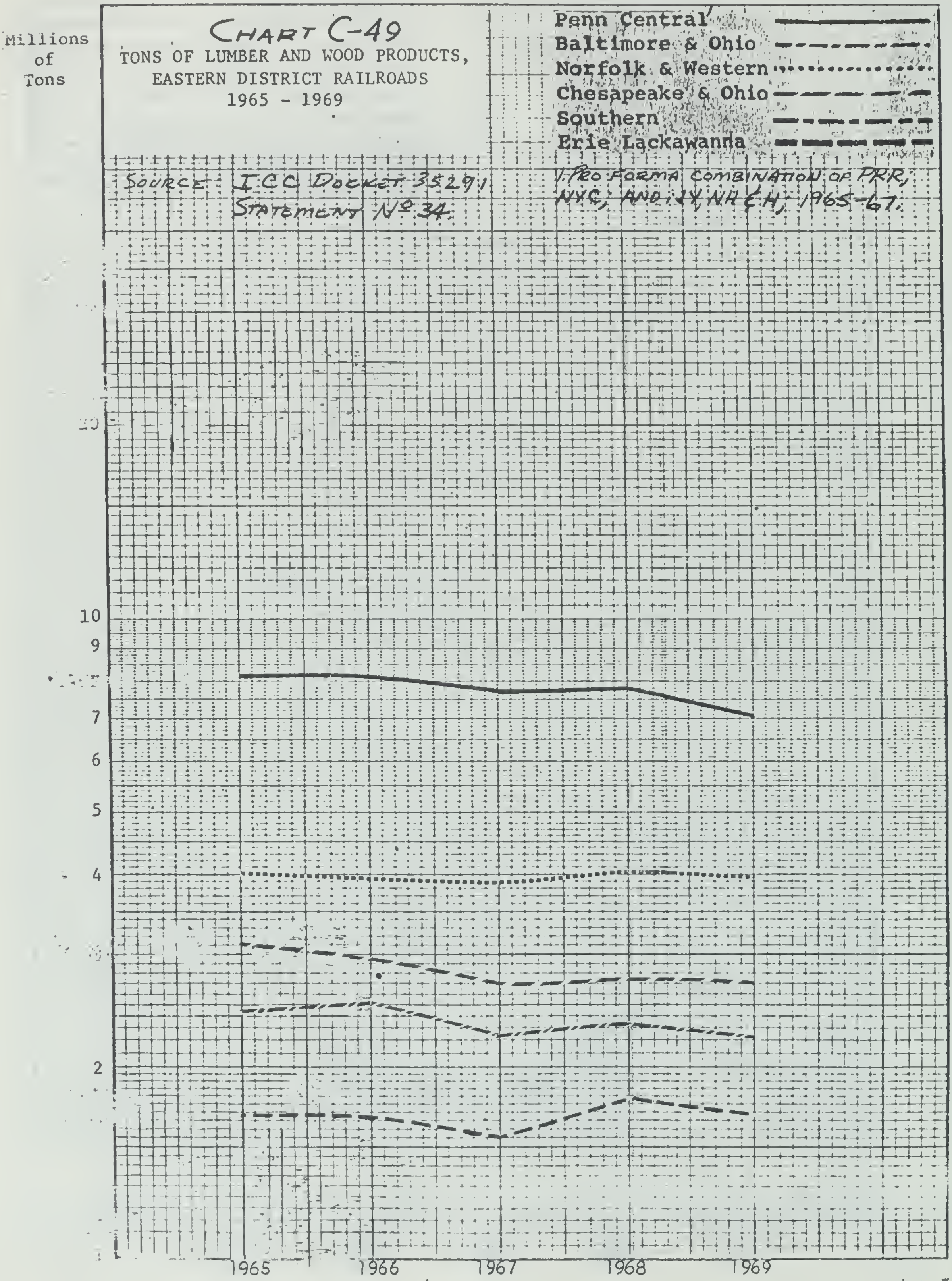
1965
1966
1967
1968
1969


Dollars
CHART C-47
FIELD CROPS
AVERAGE REVENUE PER TON
1965 - 1969
Penn Central
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
SOURCE: ICC DOCKET 35291
STATEMENT Nº 34.
4.4
4.2
4.0
3.8
3.6
3.4
3.2
3.0
2.8
1965
1966
1967
1968
1969



Millions of Dollars
CHART C-48
LUMBER & WOOD PRODUCTS - REVENUES
EASTERN DISTRICT RAILROADS
1965 - 1969
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
Source: ICC Docket 35291
Statement No 34.
1. Pro Forma combination of PRR, NYC, and NY, NH & H; 1965-67.
40
30
20
10
9
8
7
1965
1966
1967
1968
1969


Millions
of
Tons
CHART C-49
TONS OF LUMBER AND WOOD PRODUCTS,
EASTERN DISTRICT RAILROADS
1965 - 1969
Penn Central 1/
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
SOURCE: I.C.C. DOCKET 35291
STATEMENT Nº 34.
1/ PRO FORMA COMBINATION OF PRR, NYC, AND NY NH & H, 1965-67.
10
9
7
6
5
4
2
1965
1966
1967
1968
1969

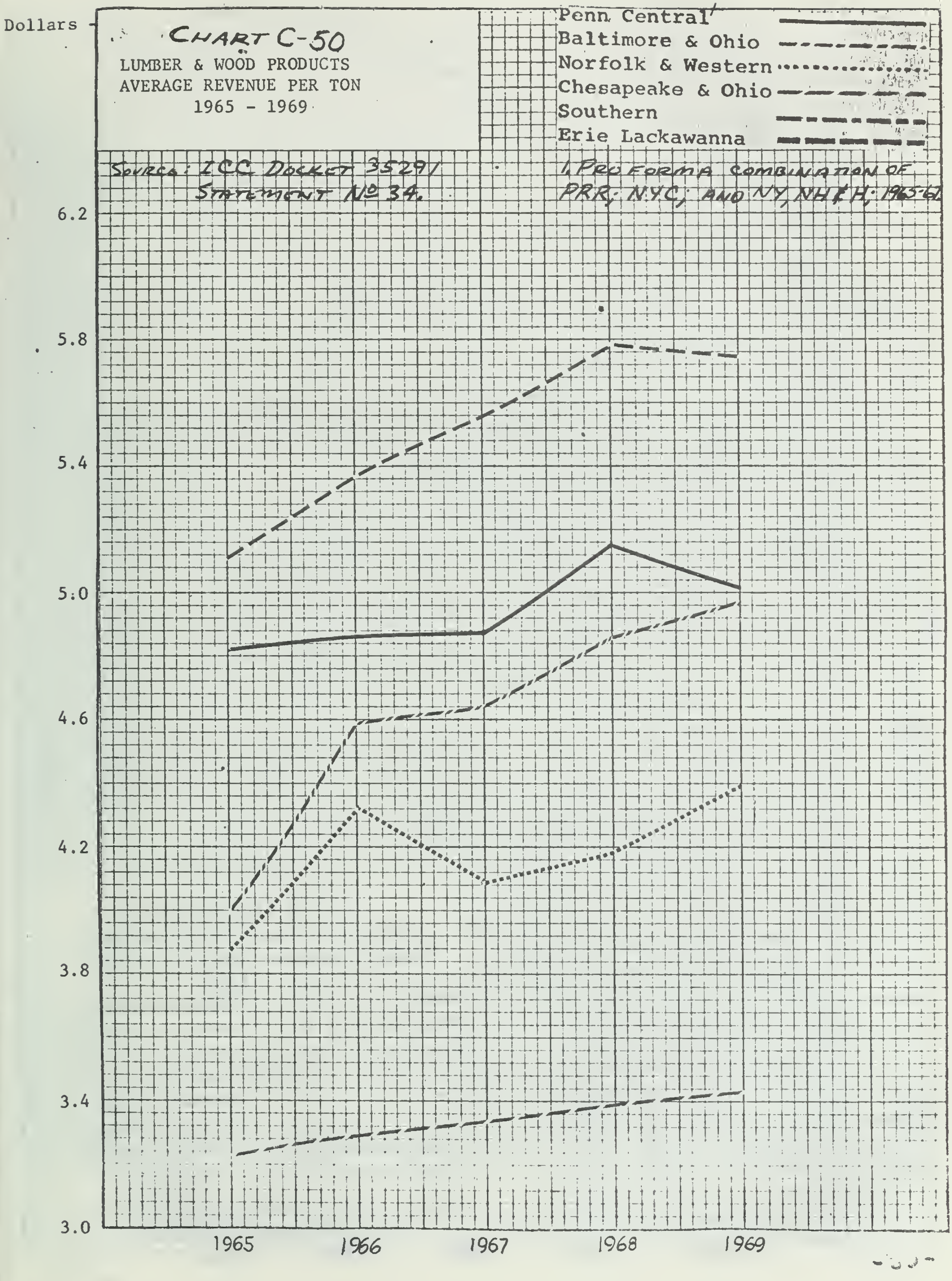
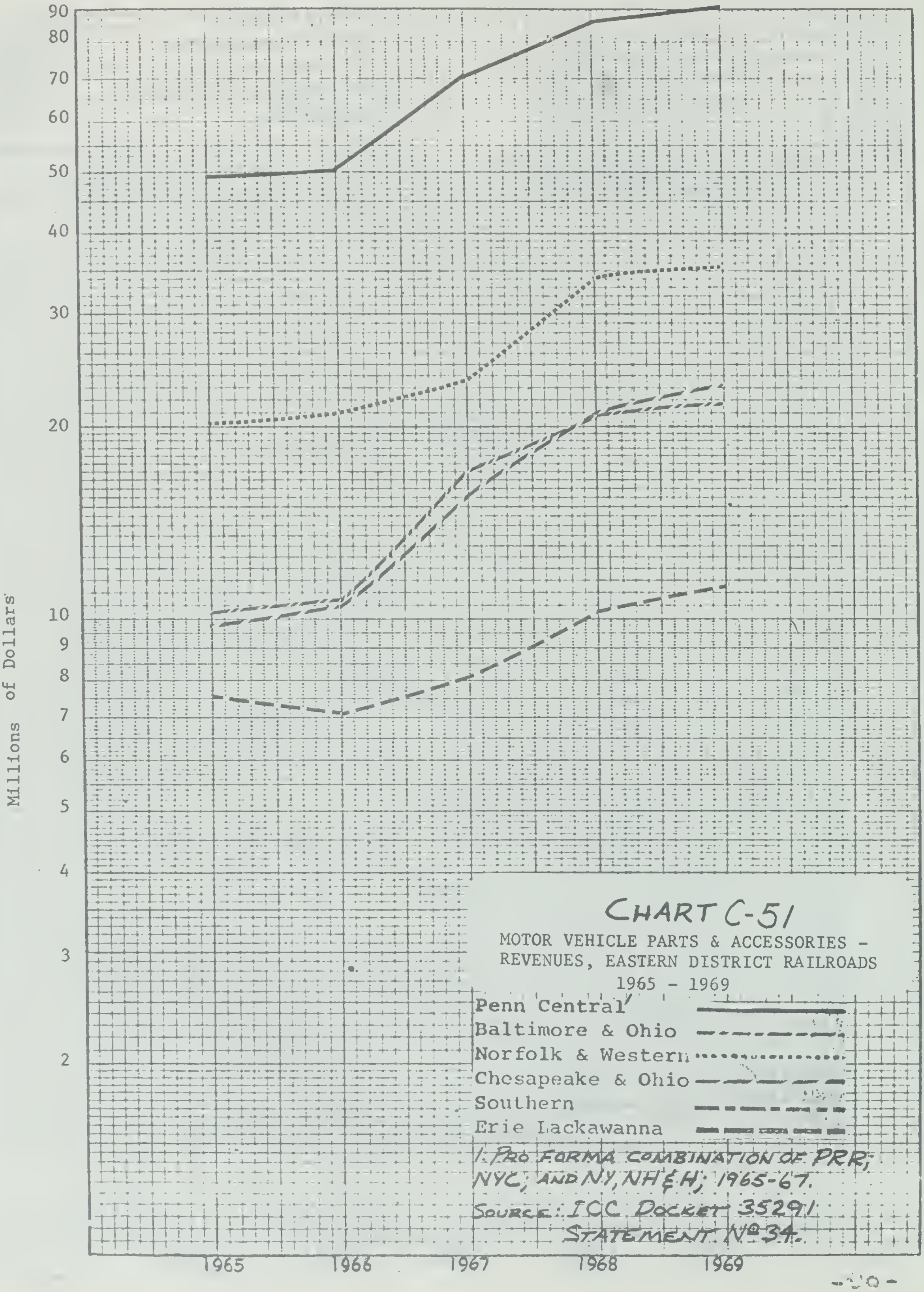


CHART C-50
LUMBER & WOOD PRODUCTS
AVERAGE REVENUE PER TON
1965 - 1969
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
Source: ICC Docket 35291
Statement No 34.
1. Pro forma combination of PRR; NYC; and NY, NH & H; 1965-67
Dollars
6.2
5.8
5.4
5.0
4.6
4.2
3.8
3.4
3.0
1965
1966
1967
1968
1969


90
80
70
60
50
40
30
20
10
9
8
7
6
5
4
3
2
Millions of Dollars
1965
1966
1967
1968
1969
CHART C-51
MOTOR VEHICLE PARTS & ACCESSORIES -
REVENUES, EASTERN DISTRICT RAILROADS
1965 - 1969
Penn Central/
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1/ PRO FORMA COMBINATION OF PRR; NYC; AND NY, NH & H; 1965-67.
SOURCE: ICC DOCKET 35291
STATEMENT Nº 34.

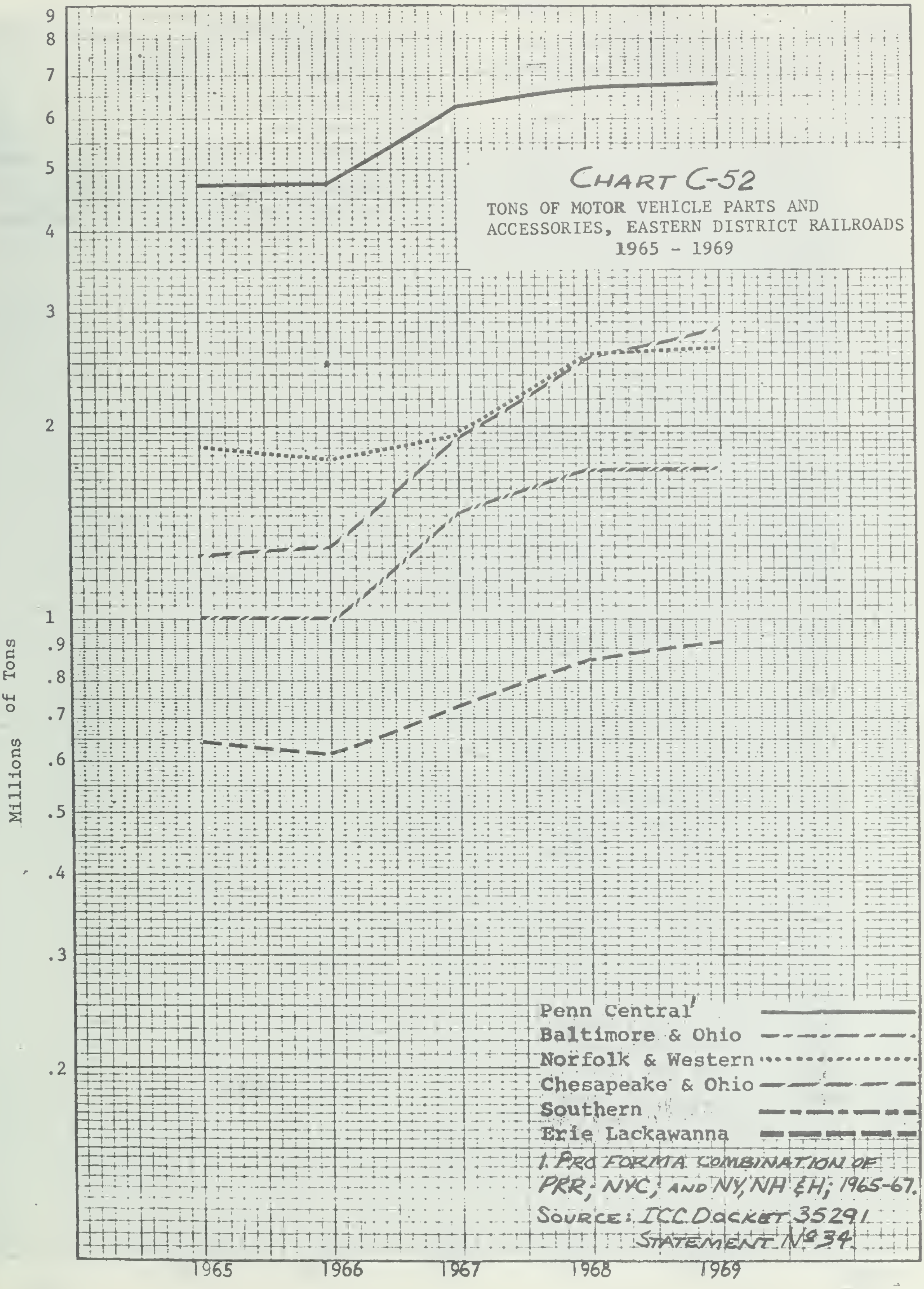
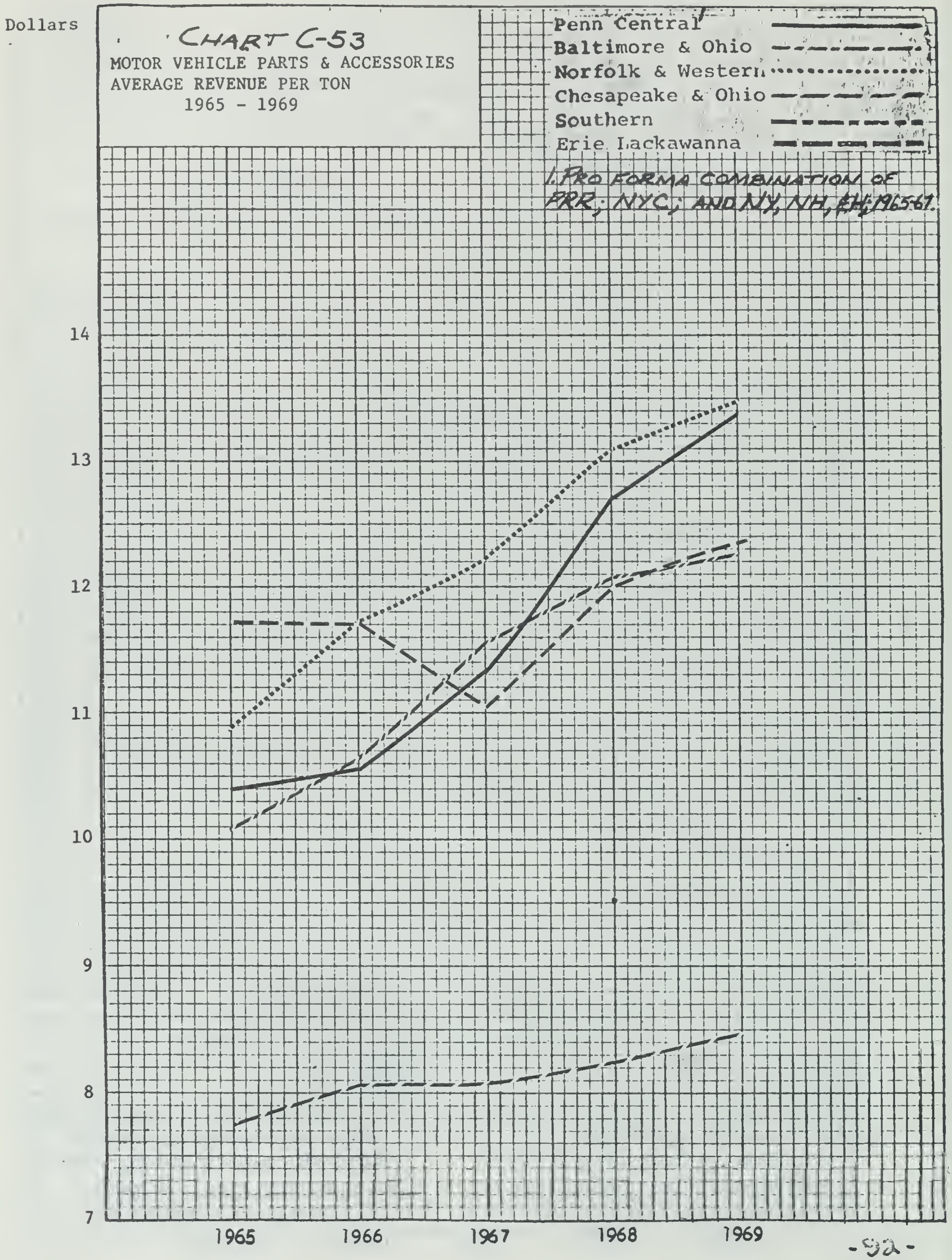
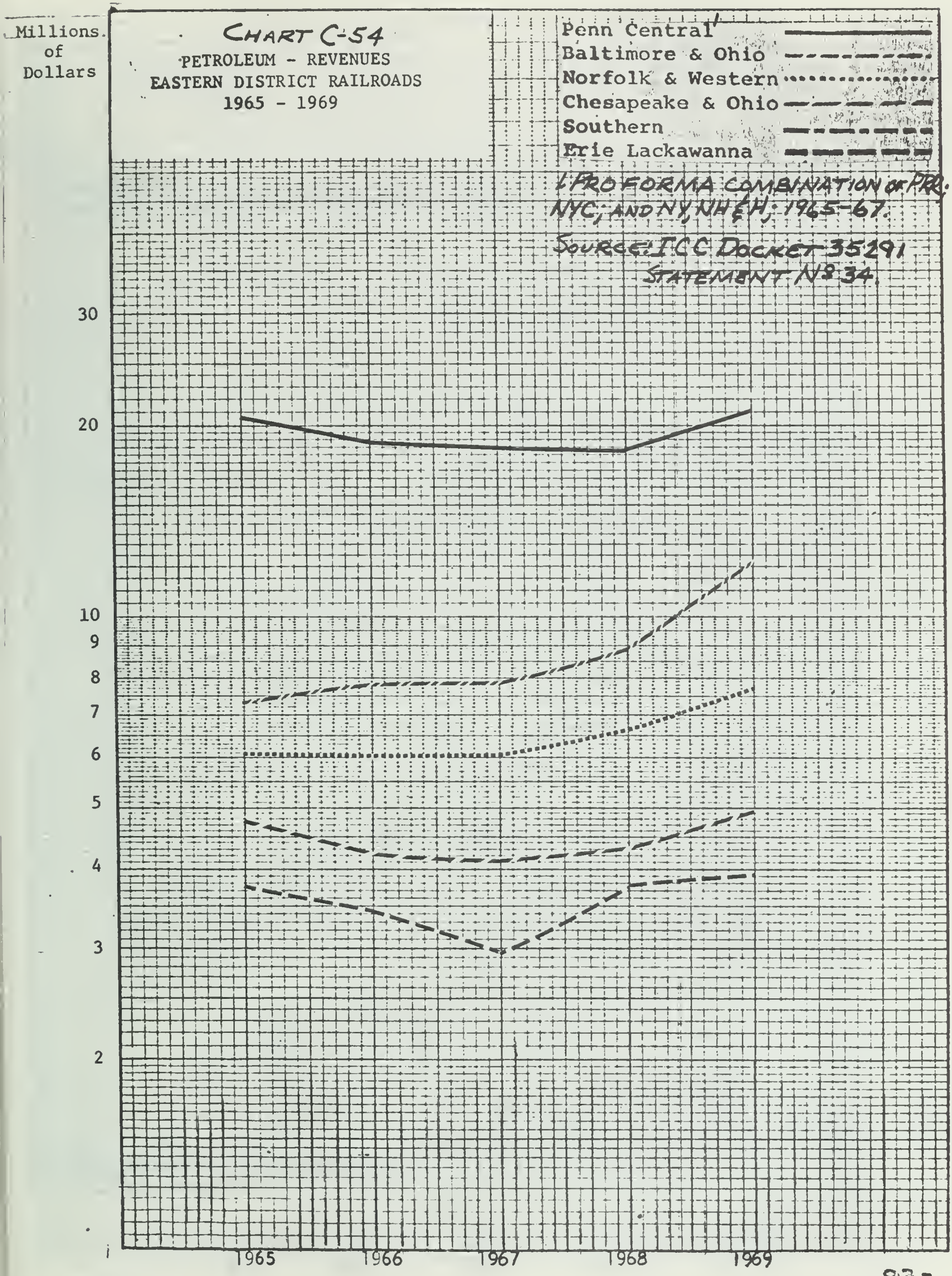


CHART C-52
TONS OF MOTOR VEHICLE PARTS AND ACCESSORIES, EASTERN DISTRICT RAILROADS
1965 - 1969
Millions of Tons
9
8
7
6
5
4
3
2
1
.9
.8
.7
.6
.5
.4
.3
.2
1965
1966
1967
1968
1969
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1. PRO FORMA COMBINATION OF PRR, NYC, AND NY, NH & H; 1965-67.
SOURCE: ICC DOCKET 35291 STATEMENT No 34.


Dollars
CHART C-53
MOTOR VEHICLE PARTS & ACCESSORIES
AVERAGE REVENUE PER TON
1965 - 1969
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1. PRO FORMA COMBINATION OF PRR; NYC; AND NY, NH, & H; 1965-67.
14
13
12
11
10
9
8
7
1965
1966
1967
1968
1969


Millions of Dollars
CHART C-54
PETROLEUM - REVENUES
EASTERN DISTRICT RAILROADS
1965 - 1969
Penn Central¹
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
¹PRO FORMA COMBINATION OF PRR, NYC, AND NY, NH & H; 1965-67.
SOURCE: I.C.C. DOCKET 35291
STATEMENT Nº 34.
30
20
10
9
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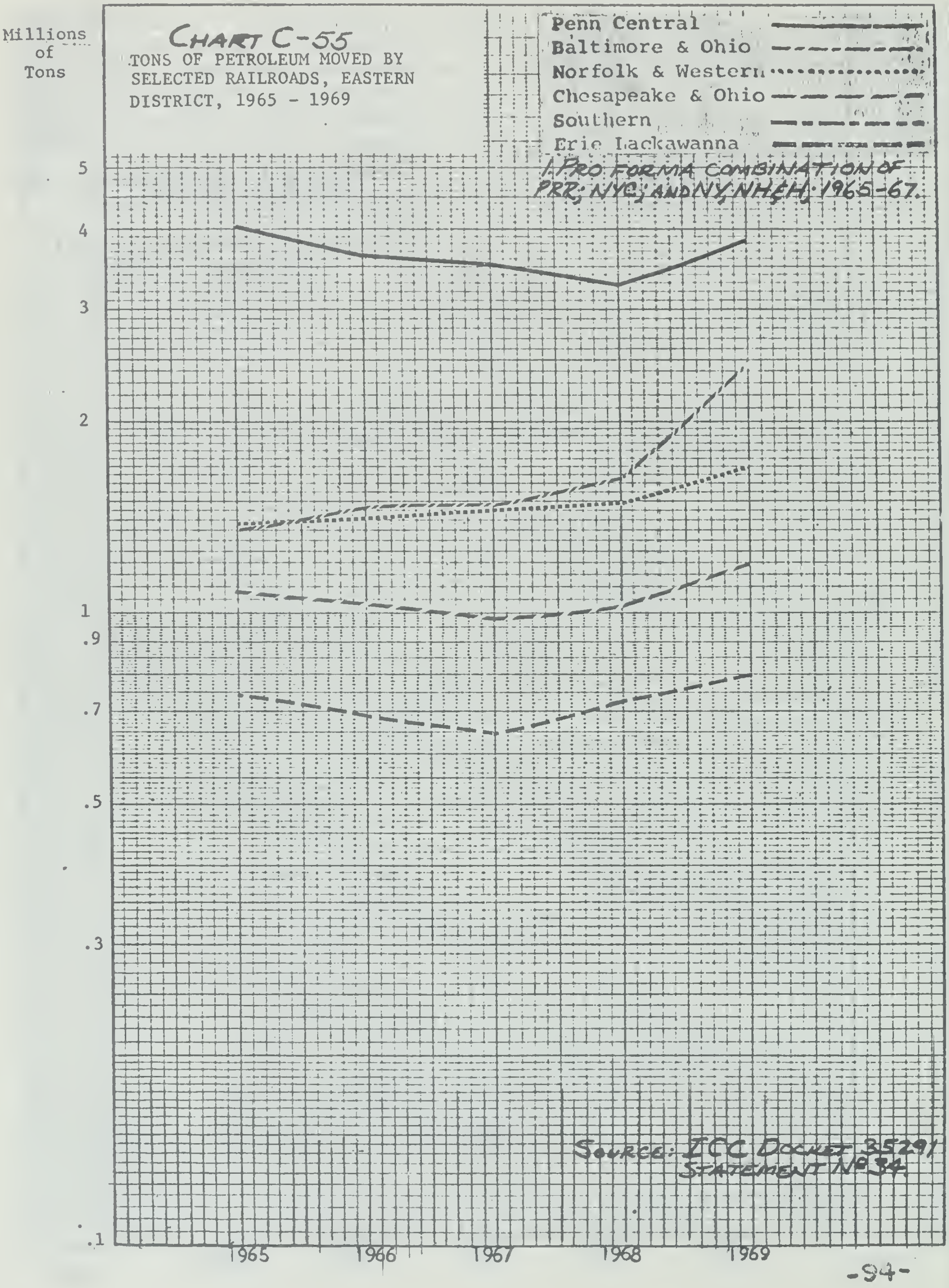
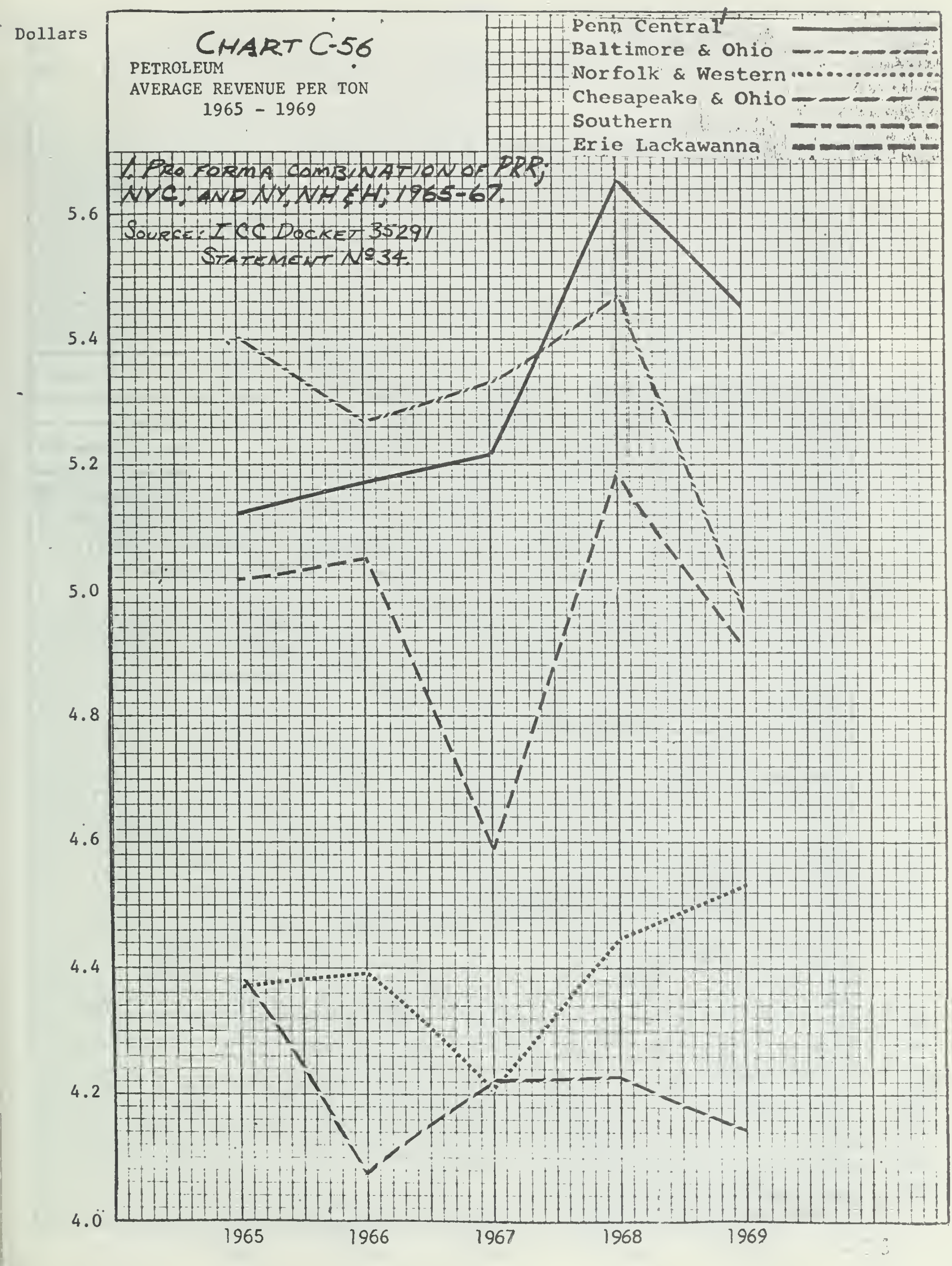
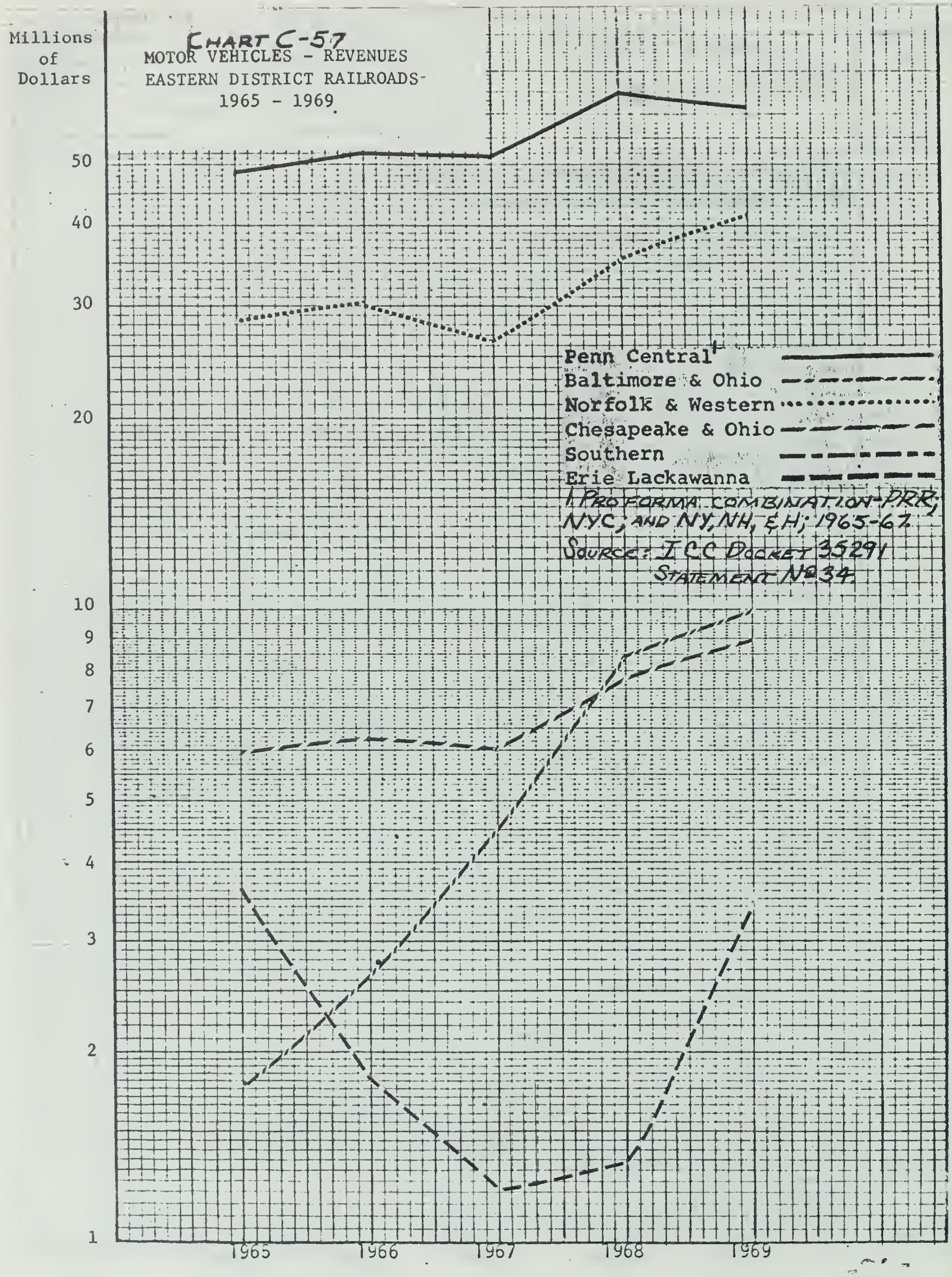
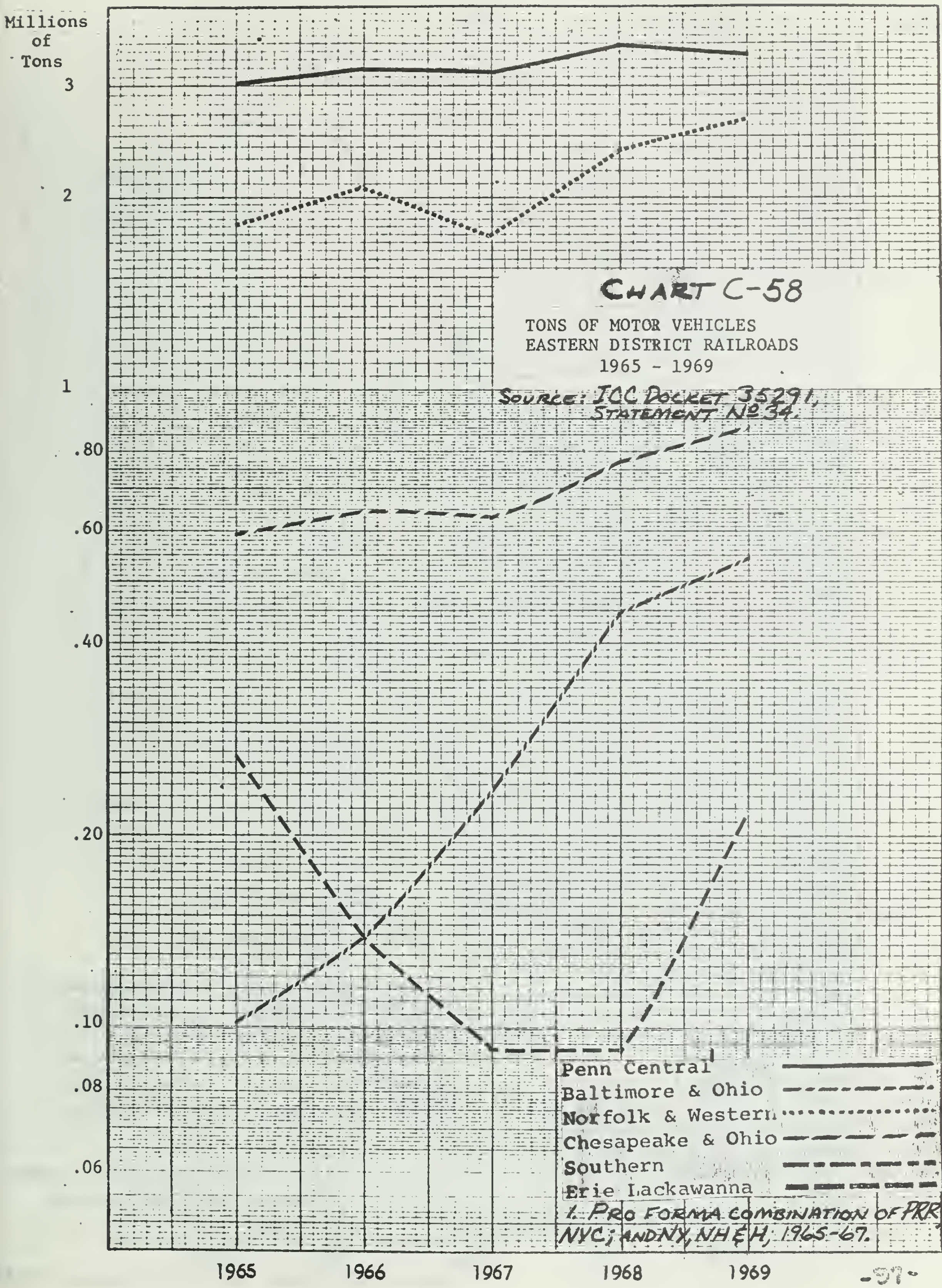
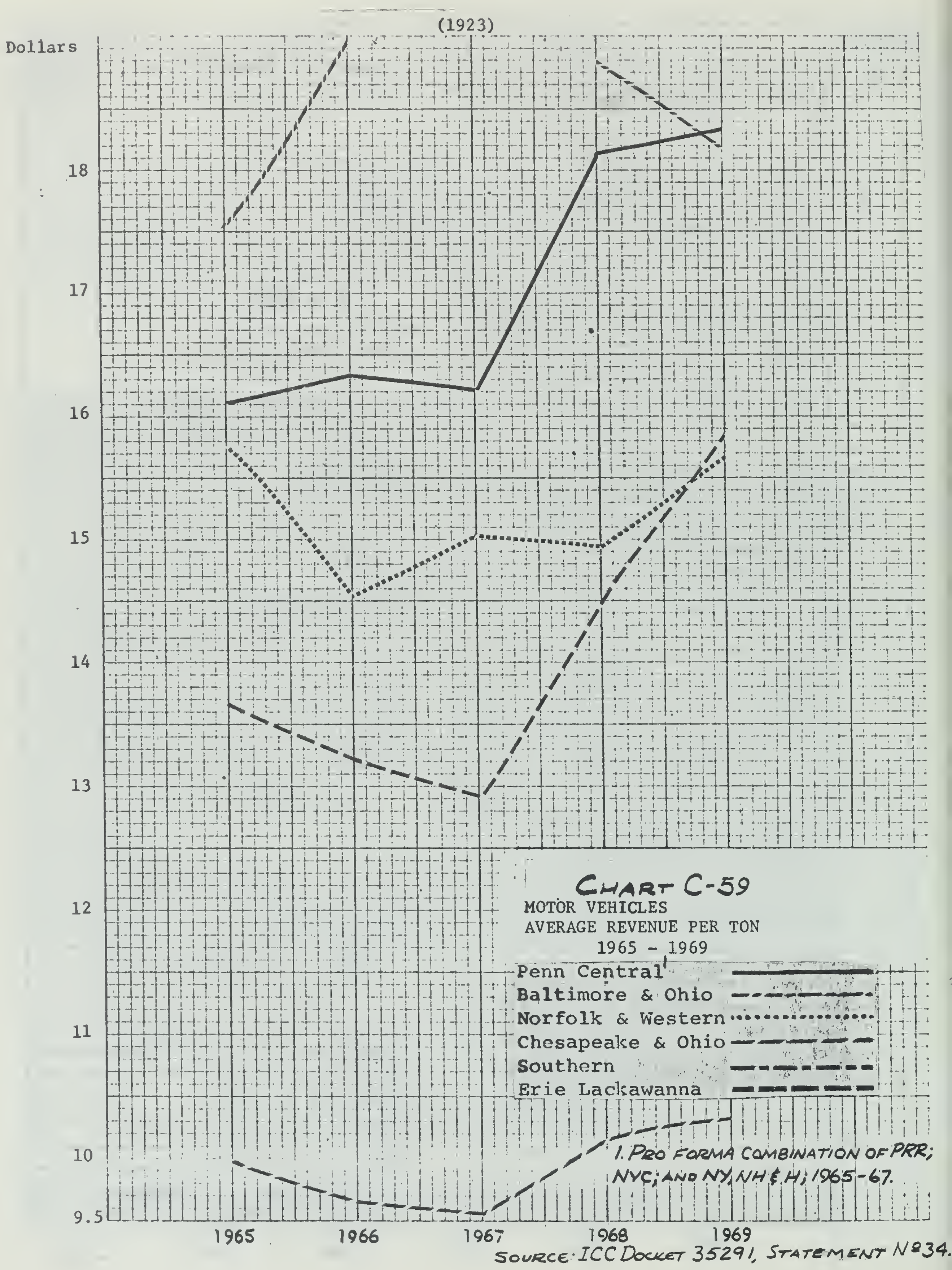
7
6
5
4
3
2
1965
1966
1967
1968
1969


Millions of Tons
CHART C-55
TONS OF PETROLEUM MOVED BY SELECTED RAILROADS, EASTERN DISTRICT, 1965 - 1969
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1 PRO FORMA COMBINATION OF PRR; NYC; AND NY, NH&H; 1965-67.
5
4
3
2
1
.9
.7
.5
.3
.1
1965
1966
1967
1968
1969
SOURCE: ICC DOCKET 35291 STATEMENT No 34.


Dollars
CHART C-56
PETROLEUM
AVERAGE REVENUE PER TON
1965 - 1969
Penn Central1
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1. Pro forma combination of PRR; NYC; and NY, NH & H; 1965-67.
Source: ICC Docket 35291 Statement Nº 34.
5.6
5.4
5.2
5.0
4.8
4.6
4.4
4.2
4.0
1965
1966
1967
1968
1969


Millions of Dollars
CHART C-57
MOTOR VEHICLES - REVENUES
EASTERN DISTRICT RAILROADS
1965 - 1969
50
40
30
20
10
9
8
7
6
5
4
3
2
1
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1 PRO FORMA COMBINATION - PRR; NYC; AND NY, NH, & H; 1965-67.
SOURCE: ICC DOCKET 35291 STATEMENT Nº 34.
1965
1966
1967
1968
1969


Millions of Tons
3
2
1
.80
.60
.40
.20
.10
.08
.06
CHART C-58
TONS OF MOTOR VEHICLES
EASTERN DISTRICT RAILROADS
1965 - 1969
SOURCE: ICC DOCKET 35291, STATEMENT No 34.
Penn Central
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1. PRO FORMA COMBINATION OF PRR; NYC; AND NY, NH & H, 1965-67.
1965
1966
1967
1968
1969


(1923)
Dollars
18
17
16
15
14
13
12
11
10
9.5
1965
1966
1967
1968
1969
CHART C-59
MOTOR VEHICLES
AVERAGE REVENUE PER TON
1965 - 1969
Penn Central[1]
Baltimore & Ohio
Norfolk & Western
Chesapeake & Ohio
Southern
Erie Lackawanna
1. PRO FORMA COMBINATION OF PRR; NYC; AND NY, NH & H; 1965-67.
SOURCE: ICC DOCKET 35291, STATEMENT Nº 34.

Merger and the Road to Ruin

THE INCEPTION

The marriage of the Pennsylvania and the New York Central Railroads, like others, got much of its style from its psychological foundations. It was certainly not born in Heaven and blessed with Love, but was strictly a marriage of convenience with a strong dose of parental fiat. "Polite cordiality" may be too generous a term to characterize the resulting relationship.

The chronology of the merger is extensive. Final and serious negotiations date from September, 1959, agreement was reached between the companies in January, 1962, and the application for approval was filed with the ICC the following August. After near recordbreaking hearings, the merger was approved by the Commission in April, 1966, and after further litigation was finally approved by the Supreme Court on January 15, 1968. With unseemly haste, the new company died on June 21, 1970.

The Penn Central combination was the last of a string of mergers that had essentially restructured the railroad system in the East in about five years. Starting with Erie-Lackawanna, the East saw the formation of new combines embracing the Chesapeake and Ohio-Baltimore and Ohio, the Norfolk and Western-Wabash *et al.*, and finally the grand culmination—Penn Central itself. The entire pattern bore to a remarkable degree the seal of the PRR as emblazoned by its chief executive of many years, James W. Symes. The Pennsylvania's influence was exercised in a general way by the vast weight of its support of other mergers, and by its courting of the Central, but more specifically through its veto power over the critically pivotal Norfolk and Western deal derived from its heavy stock ownership in the N&W and its control of the Wabash. Successful disposition of all of the other principal railroads in the East was believed to be a condition for Penn Central's approval.

The long period between the 1959 negotiations and the 1968 merger attempt brought severe change in the external operating environment and in internal company conditions. The economy was sagging, railroads generally were losing market position, and the Eastern competitors had been uniformly strengthened by their mergers. Internally, financial vitality had been further sapped.

It is customary for the ICC to attach conditions to its approval of a merger. Those arising in this case were casually prescribed, having been previously agreed upon by management and one or more of its adversaries in the proceedings. But they are of much more than casual interest or consequence. In addition to some standard requirements involving relationships with other railroads, two stand out as vital landmarks. The Commission's approval of the merger required the Penn Central to take over the bankrupt New Haven Railroad at a fancy price and with protection for labor substantially exceeding standard provisions. The intention of the governing statute is to preserve employment from merger consequences for a stipulated period. The Penn Central agreement, negotiated by the applicants and approved by the Commission, bought labor's support by a generous commitment to also recall previously furloughed workers. The inclusion of the New Haven eliminated the Executive Branch of the Federal Government and New England from the list of opponents.

MERGER PLANNING

Extensive planning was carried on over a number of years in two main stages. At the time of the first negotiations in the late 1950's, the companies jointly and separately reviewed their operations and were in the course of completing a basic plan of merger. Upon resumption of negotiations in late 1961, this work was refined into the operational plan presented to the ICC and described at length in its initial report.

After the presentation to the Commission, additional studies were made which resulted first in the Interim Plan and finally in the detailed Master Operating Plan. The Master Plan is said to have been completed after many months of effort on the part of the best informed people of both roads. The companies used a somewhat formalized organization for planning, guided by a system coordinator for each railroad and staffed by 36 representatives of 18 departments. The planning committees were to identify important decision areas, describe the approaches of the two companies, and adopt approaches for the new system.

In addition to developing the Master Operating Plan, the planning organization facilitated communication between the departments of the two companies. No formal record is readily available of the extent to which the departments had reached agreements or resolved differences relating to their postmerger organization, policies, and procedures. But there are many indications, including the abortive merger consummation attempt, that the planning was ultimately deficient.

Despite all of the apparent effort, the planning focus was primarily on a rather narrow consideration of plant design. The basic determination of the merger plan was the design of traffic routing which established the track and terminal capacity necessary to handle the expected volumes and maintenance facility requirements. But the steps or processes necessary to move from two separate roads and to achieve the design specifications were not spelled out. There is little indication that the top officers took the steps necessary to make the merger work. Stuart Saunders, PRR's executive officer, apparently devoted his efforts to the legal, political, and financial matters required to secure approval of the merger, leaving matters of operational organization to subordinates. On the other hand, Alfred Perlman, his New York Central counterpart, was more concerned with building up his company's strength as an independent railroad.

Under the circumstances, it is not surprising that planning decisions were made only in the relatively rare cases where there was consensus, leaving divisive issues largely unresolved. From the standpoint of top officials, too much public attention to the differences between the railroads might disturb public opinion and jeopardize merger approval.

The problem of evasion was compounded by the absence of real decision-making authority until the merger was formalized. Since planning was being conducted by two rather equal partners without a dominant authority able to commit both railroads, neither could be forced to make concessions. Areas of disagreement had to await resolution by the Board of the new company.

The frustrations induced by these fatal planning problems appear to be pointedly summarized in an eloquent memorandum which plaintively confided: "I am searching desperately for some concrete evidence of progress—completed projects, networks, etc.—but am finding little." [55] Subsequent performance suggests that this underlying problem persisted.

Paper planning can be effectively aided by the accommodation of organizations, facilities, and services in preparation for ultimate consolidation. This process was stifled by the long period of gestation from inception of the merger to its final approval, during which the outcome remained quite uncertain. With separate operations continuing, investments must be geared to the requirements of the individual roads, with little regard for merger-associated benefits. Neither company could spare funds for projects with a payoff conditioned by merger approval or for the entire cost of a project that might be jointly financed after the merger.

Plant investment appropriate for the Penn Central required added capacity of the New York Central far beyond its needs as a separate road. For example, the Selkirk yard required only 70 classification tracks as an individual facility but 90 tracks for the merged company. On the one hand, the only protection was an investment moratorium, but this was not practical. On the other hand, it was no more feasible to ignore the merger possibility and proceed full-speed ahead on independent courses. There was simply no satisfactory solution to the problem.

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[55] Letter from B. Cole to F. L. Kattau, August 1965; see Appendix D, Exhibit 63, p. 702.

Uncertainty about merger approval and timing also militated against accommodation in other areas such as operating and accounting procedures. Neither company could afford the cost of changing procedures that were individually satisfactory in order to adapt to an uncertain consolidation. Conflicting procedures—a reflection of incompatibility—are a common characteristic of these two large and long-time rivals. And even when new projects were adopted, such as the introduction of computers, differences of opinion about the merits of alternative approaches frequently prevented the adoption of consistent solutions.

The ICC viewed the planning requirements passively. In its initial decision of April 6, 1966, the ICC denied a petition to reopen the proceeding based on a public reference by PRR Chairman Saunders to different operating plans than those testified about at the hearings. The Commission, like the examiners, did not expect the merger plan described in the hearings to be followed in any detail. It did not pursue the matter further, apparently assuming that managerial discretion governed by survival instincts and the profit motive would insure appropriate execution. At one point, the examiners noted that it had been proposed to reduce the number of operating regions from 14 to 10, but concluded without discussion that the board of the new corporation would make the final decision on the matter.

Reflecting a host of unfavorable forces, premerger planning was largely a paper effort. Plans were produced, but little was accomplished toward resolving major interfaces—determining what was to be done and how, and accommodating differences between the two companies. The ICC was a passive onlooker through it all, no more aware of planning pitfalls than the managements or others.

The similarities of the companies dictated the types of fusion that would be required to effect the merger—essentially head-on consolidation of the physical plants rather than a linear linkage. The identity of geographic territory, parallel route structure, and similarity of size and traffic patterns meant that the benefits of merger had to come from consolidation of duplicated operations. The Central and Pennsylvania brought roughly the same things to the merger. Neither could offer any particular advantages in terms of complementary seasonal peaks in traffic, new territory, gateways, or complementary route structure. The singular benefit was the opportunity to consolidate much of their east-west traffic over the Central's water-level route. Although slightly longer in some cases than the Pennsylvania's route, it permitted bypassing the Alleghenies' mountainous grades and curves. Principally, the merger would permit the elimination of duplicating operation and facilities and the integration of the organizations.

But while the similarities dictated the merger requirements, patent differences barricaded the paths to achievement. Such differences constitute glaring incompatibilities when two partners must cooperate to perform the same tasks rather than supplementary or complementary ones.

The Penn Central was expected to be a complete consolidation of the two predecessor companies. Main line traffic was to be rerouted in order to achieve a pattern of maximum concentration of freight for the greatest distances over the New York Central's routes. The lines of the former Pennsylvania Railroad were to see a substantial decrease in traffic. The degree of consolidation is indicated by the magnitude of traffic rerouting, with estimates during the merger hearings that train-miles over the Pennsylvania's routes would decrease by one-third.[56] A switch of this volume required substantial additions to the capacity of certain terminal facilities; in fact, the hearing examiners believed construction of a classification yard at Selkirk to be "the single most significant change in terminal operations" and "the key to the merger program." [57] Inevitably, a substantial relocation of employees would be required to handle the new traffic patterns. Saunders was proud of the labor agreement he negotiated, particularly because it permitted the railroad to relocate employees.

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[56] Interstate Commerce Commission, Finance Docket No. 21989, Penn Central Merger, Hearing Examiners' Report, p. 118. Their report is reprinted almost in full in Pennsylvania R. Co.-Merger-New York Central R. Co., 327 I.C.C. 475, 566–1072 (1966).

[57] Id. p. 122.

Effecting the complete consolidation envisioned by the Penn Central required a number of steps. Basic requirements included the construction of physical facilities to handle the rerouted traffic, and the full digestion of a single set of operating procedures by employees. Uniform car control, billing, and accounting procedures needed to be devised and implemented. Another fundamental requirement was a new organizational structure specifying superior-subordinate relationships, a stable chain of command, and the allocation of decision making authority among the appropriate officers.[58]

It is evident, at least upon hindsight, that consolidation is a complicated process requiring much time and effort to achieve. It is anomalous that during the years required to establish the legality of the merger, the parties pointed toward a "Merger-day" on which the merger could be finally consummated so that the Penn Central could at once begin to operate according to its ultimate design. Little thought was apparently given to the difficult process of forging one company from the pieces of its predecessors. Although it was acknowledged beforehand that the full amount of merger savings would not be available for eight years, the basis for this delay was usually attributed to the costs of plant construction and labor protection. Costs resulting from the process of consolidation were unexpected.

When final approval came and consolidation began in earnest, the fundamental decision about traffic routing had been made; the key terminals, yard and connection work had been identified. It now remained to implement those plans. This was no small task as the record of activity for the following two years indicate.[59] Ten classification yards were built or enlarged, 35 key terminals were consolidated; four yards were eliminated in 1968 and two in 1969; and numerous rail connections were made.

The Pennsylvania Railroad's desperately declining cash position gave no time to pursue a leisurely pace with the consolidation effort.[60]

Accordingly, just as soon as the Supreme Court decision of January 15, 1968 permitted the merger, the Pennsylvania Railroad rushed ahead with enthusiasm, aware that it would run out of cash if left on its own. Although the attitude at the New York Central is not set out as explicitly as the Pennsylvania's in the records, it was probably about as anxious because of its critical cash needs. Not surprisingly, the two companies found themselves no stronger in union than as independents. Immediate action had to be taken to keep the Penn Central afloat. Since top management believed the decade of rhetoric that vast savings would occur upon the consolidation of the two railroads, they undertook a crash program to achieve those savings as soon as possible. There is no evidence that any serious consideration was given to a more gradual program.

Several months after the bankruptcy, Alfred Perlman testified to the Senate Commerce Committee with obvious pride that physical work originally scheduled for completion in five years had been done in two.[61] Apparently, most of the merger startup costs were expended in 1968 and 1969 rather than prorated over the longer period. Perlman regarded this as a tremendous achievement.

Upon merger, Penn Central expedited some plans and postponed others in the search for instant economies. By November 1968, PC had implemented the basic protective contract through agreements with unions representing 86 percent of its organized employees. Accordingly, it proceeded with the relocation of personnel, consolidated facilities, reduced the work force, and terminated employment under the interim pensions and separation allowances pro-

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[58] It is terminologically useful to use "merger" to indicate legal and financial aspects of the combination of the railroads and "consolidation" to indicate the organizational aspects. Merger occurred when corporate officials signed the necessary papers on February 1, 1968. Consolidation, on the other hand, involved the reorganization of employees into new work patterns and a change in the physical flow of traffic over the rails. It required people to perform new functions or old ones differently. For example, the C&O and B&O merged, but they did not consolidate to any great extent; by and large, they were operated as before the merger.

[59] See, e.g., testimony by S. T. Saunders, Hearings before Senate Committee on Commerce, *Failing Railroads*, 91st Congress, 2d Session, Serial No. 91–90, Part 1, at pp. 310–11 (1970).

[60] The PRR's cash position (expected to go to zero within 2 months) also dictated a plan to sell about $72 million in debt securities. To do this, the Pennsylvania would be forced to obtain agreement from the New York Central to raise the debt limits set in the merger agreement for the third time. Memorandum from Bevan to Saunders, November 8, 1967; see Appendix D, Exhibit 36, p. 558.

[61] Hearings before Senate Committee on Commerce, *Failing Railroads*, 91st Congress, 2d Session, Serial No. 91–90, Part 2, at p. 393 (1970).

vided by the labor contract. The actual cost of the labor protective agreement greatly exceeded estimates. Management either must have decided to follow a greatly accelerated program to achieve economies or misused the contract arrangements by improvident transfers and separations.

Staffing decisions were very important in view of the abruptly changing operating patterns. Shortly before merger day, the two chief executive officers, Saunders and Perlman, selected personnel from the companies for the upper levels of PC management. As provided in the merger agreement, Saunders would be chairman and chief executive officer and Perlman president and chief administrative officer. Of the departments selected to report to the president, three of major importance (operations, sales/marketing, and personnel) were headed by former PRR men, and three NYC executives were in charge of accounting, industrial development/real estate, and purchases/materials. Four central executives also reported to the president for departments handling various research, systems development and management planning functions and miscellaneous services. Directly under Chairman Saunders were the finance department, the secretary's office, the legal department, and public relations, all headed by former PRR personnel.

In the second and third level staff positions were persons from both companies, about equal in number overall, but not evenly distributed among departments. For example, in the operating department, under the executive vice president reporting to the president, were seven former NYC and three former PRR officers. In general, however the Penn Central attempted where possible to intermingle former New York Central and Pennsylvania Railroad employees. They were placed side-by-side and frequently superior-subordinate relationships were arranged so that an employee of one railroad reported to someone from the other.

Post bankruptcy statements tended to rationalize the drastic service deterioration as a calculated cost of the forced draft approach. When asked by Senator Hartke whether expected merger benefits of efficiency and better service had been realized. Mr. Perlman replied:

> No, sir, not the first 2 years and I didn't expect them to occur then, When we rebuilt the yard, say at Albany before merger, put in the new electronic yard, we had to throw everything over to the Syracuse yard. Just that one thing disrupted the New York Central service for 6 months. Now you take changing service at 35 yards within one year and you have got a heck of a mess.[62]

There was no indication that strategies designed to minimize service deterioration during consolidation had been considered. This testimony clearly revealed a belief that service deterioration was a necessary by-product of the consolidation process and that the faster the consolidation could be accomplished, the faster service could be restored to acceptable levels. Speed was the only criterion. whether due to the financial straits of the railroad or to a preference for a briefer sharp pain over a prolonged dull ache is not important since the direction given to the consolidation is the same.

THE MERGER AFTERMATH

Well documented and publicized, the service deterioration resulting from consolidation exceeded even the worst expectations. It involved no billing, or multiple billings for countless shipments, misrouted cars, and even lost trains. Yards were so jammed that many cars were kept floating around aimlessly for want of a place to rest. Angry and frustrated shippers took their traffic to other more reliable carriers when they had a choice.

In its post-bankruptcy investigation, the ICC's Bureau of Enforcement considered as critical the congestion at key terminals and yards, and the inability of unprepared clerical forces to execute the classification and routing of combined traffic. Massive communication problems were also identified.

The incompatibility of the PRR and NYC computerized car location and movement information systems was not corrected until June 1968 although the problem was recognized well in advance of the merger. Shortages of loco-

[62] Id at pp. 391–2.

motive power seriously delayed train movements and aggravated the problem of an insufficient supply of freight cars. The handling of traffic interchanged with connecting lines, the Bureau asserted, was thoroughly confused at both the eastern and western connections.

The total breakdown portrayed in this dismal recital does not reflect excessive size as much as ineffective consolidation. Chairman Symes pointed out in his merger case testimony that the merged company would not be as large in many respects as the separate companies in the past.[63]

Nor is Chairman Saunders' post-bankruptcy contention that the company was unmanageable pursuasive if the reference is to size disabilities. The only valid meaning clearly is that the *merger* was unmanageable as it was undertaken, or that the company was unmanageable when operated with the shackles of a half-digested merger. The ability of the succeeding management to manage the property with the integration process reasonably complete is rather compelling witness to this view. The problem was not size *per se* or the merger *per se*, but precisely the inability to truly consummate the merger.

While the disruption caused by the construction projects and physical changes in the traffic routing were influential, they may be easily overemphasized because of their close identification with the physical manifestations of chaos. More fundamentally, however, the collapse was triggered by an organizational crisis. The rush to consolidate effectively destroyed the organizations of the predecessor companies and the Penn Central was unable to generate in time its own new cohesive and coordinated organization. The disruption caused by physical changes in the plant was compounded by the inability to put the pieces of the companies back together again. A key element in every organization is a structure of management personnel that is able to provide effective leadership. This must be doubly important when the disruptions of massive changes are present. Yet, a stable management structure was not created at the Penn Central. A revealing account of the organizational deficiencies of the Penn Central is set out in the Interim Report of the President's Task Force, just two and a half months before bankruptcy.[64] A measure of management instability is the very large turnover in management personnel at all levels indicated by the following proportions of incumbents in their present assignments less than one year:

61% of Trainmasters;
81% of Transportation Superintendents; and
44% of Division Superintendents.

In addition, all but one General Manager and 80% of Division Superintendents were in their present assignments less than 15 months.

The report concludes "that the tremendous turnover in supervision has had an adverse effect on operations and control," and says, "Nearly every other problem we saw could be related to supervisory personnel that were not yet qualified to handle the duties and responsibilities delegated to them."

Changes in management personnel extended even into the executive suites. By the end of 1969 Mr. Perlman was no longer President; the Executive Vice President for Accounting, Mr. Grant, the Executive Vice President for Operations, Mr. Smucker, the Senior Vice President for Labor and Personnel Relations, Mr. Knight, the Vice President for Transportation, Mr. Kennefic, and the Vice President—Corporate, Mr. Gerstnecker, to name a few principal officers, had left the Penn Central.

It was significantly observed that the Central Region was less affected by merger problems than other sectors. Officers there had recognized the value and need for an adequate degree of stability in regional and divisional supervision. As a result, most supervisors had been in their present assignment for at least two years at the time of the inquiry. The rampant disorganization up to the time of the Task Force report was not a necessary result of the merger; the better performance of the Central Region shows that the situation was amenable in a meaningful degree to managerial control.

[63] The measurements of size to which he referred included number of employees, cars and locomotive units owned, revenue passengers handled, revenue ton miles, and total train miles.

[64] Mr. Gorman, who became president in December 1969, created the special task force to evaluate the activities and functions of the operating regions. See Appendix D, Exhibit 64, p. 702, for full text of "Interim Report—President's Task Force" dated April 6, 1970.

Other indications of disorganization the Interim Report spotlighted included the lack of uniform procedures for payroll processing, car reporting, and management reports; poorly defined duties and responsibilities in some supervisory positions and territorial differences in the scope of the activities, and unevenness in promotion and training programs.

The Interim Report also noted a failure to adhere to the operating plan. This point was earlier made by the former Executive Vice President for Operations who said that savings on merger projects had fallen short of estimates by 50 percent. Asserting that neither the Master Operating Plan nor the previous plan (placed in the record of the ICC merger hearings) had been followed, he stressed the need for effectuating future guidance.[65]

Other external factors indicate the accuracy of the thrust of the allegations. The emphasis on speed and the associated disruptions of consolidation would make following any plan difficult. In addition, Perlman was noted for his propensity to run a railroad from information in his head and intuition rather than from formal plans. His method of operation on the New York Central apparently was to travel over the railroad to spot problems to be corrected. It is, therefore, not unlikely that he would have continued to devise *ad hoc* solutions to the manifold problems of the Penn Central rather than follow a plan.

The lack of defined responsibility for important supervisory positions and lack of uniformity between regions further indicate that changes or reorganizations were not made systematically. According to the Interim Report, divisional and regional supervisors of data control and operating rules, of yard procedures, of train movement, and chief dispatchers, among others, were forced to rely on their past experience or differing individual ideas for job definitions. This is astounding in view of the vital importance of information and efficient train operations toward making a success of the Penn Central. The Report recommended definition of duties and responsibilities for each supervisory position in the Transportation Department as "a necessary first step toward establishing transportation guidelines that will be uniform throughout the company." Two years after the consolidation began is woefully late for such important first steps to be formulated.

Disorganization was by no means confined to the transportation department. Peat, Marwick, Mitchell & Company, certified public accountants, were hired to perform an outside investigation of the freight billing system. Their December 22, 1969, report found excessive delays in billing, inadequate management control over the quality and promptness of billing, poorly trained and confused personnel and a management structure that threatened the integrity of financial control by its very organization.[66]

Lacking a positive control system, errors generated in the system continued throughout the entire cycle until brought to the railroad's attention by customers. Peat, Marwick suggested initiation of comprehensive training programs for freight billing personnel, especially those who dealt with disputed rates. They recommended a change in organization to remove agents from the control of trainmasters. Trainmasters are responsible for moving cars and trains while agents are responsible for the documentation of movements. Priority was naturally given to car movement by trainmasters and agents were often used by them for operating duties when pressing agency problems deserved their undivided attention.

Because of poor management, the freight billing process of the Penn Central was slow and money due it remained in the hands of customers. Thus, poor management thwarted the prime purpose of speeding the consolidation process—to obtain funds to stave off collapse.

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[65] Memo from Smucker to Saunders, Nov. 13, 1969. Since Smucker had been ousted from his position as Executive Vice President for Operations nine months before, the credibility of his memo might be questioned. However, the coincidence of his view and that of the Interim Report support the proposition that a uniform plan was not adhered to on the Penn Central. The press has recorded a bitter dispute between Smucker and Perlman and concluded that Perlman succeeded in dumping Smucker. R. Loving, *Fortune*, "The Penn Central Bankruptcy Express" (August 1970). Saunders later claimed that he and Perlman agreed that Smucker had not done the job and that together they replaced him. J. Daughen and P. Binzen, *The Wreck of the Penn Central*, p. 121 (1971). For text of Nov. 13, 1969 memo, see Appendix D, Exhibit 65, p. 704.

[66] Letter and report from Peat, Marwick, Mitchell & Co. to C. S. Hill, Dec. 22, 1969; see Appendix D, Exhibit 66, p. 705.

There are indications that management had trouble determining what statistics to collect for operating reports. When management did make up its mind, it had difficulty in obtaining accurate and uniform data.[67]

Disputes as to marketing philosophy and organization of the marketing and sales department continued to the end of 1968. It is not clear that the matter was finally resolved at that time. In any case, the result was dissatisfaction among the former members of the New York Central marketing staff and their departure from the Penn Central in substantial numbers. These events provide a sample of the organizational problems that afflicted the Penn Central.

MERGER EVALUATION

Public Processes

The basic law governing rail unifications has not changed since the Transportation Act of 1940, made § 5(2) to (13) of the Interstate Commerce Act, inclusive, applicable to all carriers regulated by the ICC. The law made it possible for PRR to have the power to veto, if not to control the ultimate revision of the structure of railroads in the East. Since prior to 1920 when unification provisions were first added to the Interstate Commerce Act, PRR had a substantial stock interest in N&W which served the lucrative Pocahontas coal fields. Evidently the ICC did not consider the PRR–N&W affiliation harmful since it was undisturbed until approval of the N&W–NKP–Wabash system in June 1964, which was conditioned on divestiture by the PRR of its interests in both N&W and Wabash. PRR consented to the divestiture. By that time, the C&O control of B&O authorized in December 1962 had been consummated, and the system was in operation.

Although in the *N&W Merger* case, the ICC disavowed that it was systematically restructuring the Eastern system, its approvals created by the end of 1964, two new systems, N&W and C&O-B&O, built around the cores of two strong railroads over three years ahead of the consummation of the Penn Central merger. Both had direct access to the important industrial areas of the East and ocean ports as well as to the Pocahontas coal fields. Penn Central had somewhat broader territorial coverage and in many respects equalled C&O–B&O and the new N&W combined. The 1965 proposal to form an N&W/C&O–B&O system was based in large part on the alleged necessity of meeting the coverage and competitive strength of PRR and NYC unified as Penn Central.

The ICC was committed early to a case-by-case method of deciding the unification proposals, and repeated efforts to change that approach failed. The basic applications for approval of the three new systems were filed in a period of less than two years (June 1960–March 1962), and at the time of the Penn Central hearings in 1963, all were still pending before the ICC. The ICC's decisionmaking method may have simplified administrative handling, but it prevented overall public consideration of the merits of the several unification plans in the context of national and regional goals and needs.

Given the ICC's passivity it is difficult to say whether consolidation of the cases would have yielded different results. The ICC is empowered to condition but not compel a unification of carriers. Any railroad not satisfied with conditional approval can refuse to proceed with a proposed unification. C&O's refusal to join in a C&O–B&O–NYC system is said to have forced NYC out of the *C&O–B&O* case and into the proposal to merge with PRR. The dangers to NYC were recognized and were briefly treated in one paragraph of the ICC's 1962 decision approving the C&O–B&O affiliation. The Commission realized that the Central was "not well able to absorb any substantial loss of traffic", but concluded that the prospective loss of revenues to NYC was not such as to require disapproval.

The C&O–B&O affiliation consummated in February 1963, is often regarded as the keystone of the present alignment of Eastern railroads. At that time, apart from statutory standards set out in the Interstate Commerce Act and the antitrust laws, Government policy relating to mergers in the railroad and airline industries was being developed. President Kennedy, in his April 5, 1962, message to Congress, directed the Departments of Commerce, Justice, and

[67] Cf., Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation, Bureau of Enforcement Brief, pp. 32–6 (Mar. 8, 1972). Appendix D, Exhibit 74, p. 733.

Labor and the Council of Economic Advisers to form an interagency committee to develop criteria to determine whether proposed mergers are in the public interest.

The message stated three general guidelines. The first provided that effective competition should be maintained among alternative forms of transportation and, where traffic volume permits, among competing firms in the same mode of transportation. The second aimed to secure economic, efficient and adequate service to the public "by the realization of *genuine* economies." Under the third, affected workers should be aided in making necessary adjustments caused by a merger. The Interagency Committee on Transport Mergers issued its report stating the general criteria in January 1963 after ICC approval of C&O–B&O control the preceding month and a few days before consummation of that control.

On October 1, 1963, the Interagency Committee made a public statement opposing the Penn Central merger. That merger, it claimed, would eliminate a vast amount of beneficial rail competition. The committee referred to the dominance of the merged company in the East and saw danger to several smaller railroads not included in the merger. The merger, it said, would preclude a more balanced restructuring of the East.

The Department of Justice had intervened in both the *C&O–B&O* and *N&W Merger* cases. In the first, it did not oppose approval, but urged consolidation of the two cases with the PRR–NYC proceedings. In the second, it made a similar contention, but also pressed for inclusion of Erie-Lackawanna in the transaction, and stipulated into the record a memorandum developing the ties between N&W and PRR since about 1900. In a brief before the examiner, it asserted that, by reaching agreements with various intervening railroads, N&W succeeded in silencing all carrier opposition to the proposed merger. As a result, the Department said, the record was inadequate to enable the determination of the public interest issue and the applications should be denied. At the oral argument, the Department maintained that the proposals should be approved only if PRR's financial interests in N&W were eliminated and Erie-Lackawanna included in the transactions. The Commission found the record adequate, approved the N&W merger without requiring inclusion of EL at that time, and ordered PRR's divestiture of its interest in N&W and Wabash as a condition of approval.

Commissioner Tucker dissented in both the *C&O–B&O* and *N&W Merger* cases. In a lengthy dissent in *C&O–B&O* in December, 1962, he commented that the public bodies are not in a position to present public, as distinguished from private, evidence. He picturesquely described the failure of large Eastern railroads to present opposing evidence to the natural consequence of their own self interest "which dictates a reciprocity of silence." In the *N&W Merger* case in June, 1964, he considered that a unification proposal dealing with the entire region submitted on a relatively "noncontroversial" record was deficient in some respect. On the other hand, he noted with some foreboding the rather formidable opposition to the PRR–NYC merger, not the least of which was the President's Interagency Committee on Transport Mergers.

The Interagency Committee opposition disturbed PRR and NYC and evidently intensified their efforts to neutralize the protests against the merger. After C&O–B&O control was effected and the new N&W system organized, and with the Penn Central record finally closed in September 1964, within the next year the ICC was confronted with three alternatives for restructuring railroads in the East—two systems (Penn Central and N&W–C&O proposed by their application filed October 11, 1965), three systems (C&O–B&O, N&W with possible additions and Penn Central), and four systems (C&O–B&O, N&W, PRR and NYC).

The Department of Justice, representing the Government, was party to the more important merger cases before the ICC in the 1960's. It opposed the merger of the Northern Lines in the West through the Supreme Court. It participated in the *Seaboard Coast Line* merger case settling how the antitrust laws are to be applied to rail mergers. In *Penn Central*, its position changed from unqualified opposition to the proposed merger at the time of the examiners' report in March 1965 to agreement that the proposed merger was in

the public interest before the Supreme Court in 1968. At the time of the initial ICC decision in 1966, the Department was urging a four-system East (PRR, N&W, C&O–B&O and NYC) and that if the time came when four systems could not be supported, then PRR should be consolidated with N&W, and NYC with C&O–B&O. Whatever the changes in position, the Penn Central merger encountered substantial opposition, that opposition gradually disappeared, the merger nonetheless had thorough consideration, and its approval created the present three-system East.

Delay is inevitable in any unification of carriers. In *Penn Central*, the six-year delay gave the two railroad applicants ample opportunity to allay the substantial opposition and provided time to refine their extensive plans for physical merger. However, the realization of the anticipated economies was postponed, substantial losses continued, plants deteriorated, working capital continued to decline, new rail competitors were solidifying their positions, and so the many pressures induced substantial concessions not only to obtain but also to expedite approval.

Delay did not bring change in the January 1962 merger agreement between PRR and NYC that provided for an exchange of stock in the ratio of 1.3 shares of NYC capital stock for one share of PRR capital stock. The initial ICC decision in April 1966 approved this exchange. Maintenance of the ratio influenced the managements of the two railroads in making short term decisions affecting profits. To what extent those decisions weakened the two companies from the standpoints of their financial well being, operating capabilities and physical condition of plant is discussed in the fiscal policy discussion of this report.

The ICC recognized the importance of public overview of the merger. On August 19, 1966, while it was reconsidering its initial merger approval issued in April of that year, the Commission required the applicants to file reports designed to keep the Commission completely and currently informed of the progress made by Penn Central in achieving economies and efficiencies after consummation of the transaction. Upon later petition of the Department of Justice, the Commission on May 21, 1968, vacated the 1966 order and required Penn Central to file a "Performance and Status Report" for each of five calendar years beginning with 1968.

Penn Central filed two performance and status reports. Both reports disclosed difficulties. The first for 1968 said that temporary impairment of service undoubtedly resulted in loss of traffic volume and produced unusually heavy costs in per diem and overtime payments. It estimated that merger startup costs and losses approximated $75 million. The merged company, the report went on to say, elected to endure high initial costs, as the price of accelerated change, in order to realize more quickly its goals of improved service and merger savings in subsequent years.

In the second performance report, which included also the New Haven as part of Penn Central, the records were said to indicate for the year 1969 merger expenses of approximately $37.6 million and merger savings of approximately $51.7 million. This report was filed March 31, 1970, shortly before Penn Central announced its first quarter 1970 consolidated loss of $17.2 million.

By that time, the Commission was acutely aware that Penn Central faced perilous conditions. By application filed September 12, 1969, Penn Central sought authority under ICA § 20a to issue its short-term, promissory notes in the form of commercial paper in total amounts not exceeding $50 million outstanding at any one time. The report of the Commission expressed serious doubts. It pointed out that commercial paper notes are ordinarily drawn for a 270-day or less maturity, while the proposed notes would have a maturity as long as one year from the date of issue. It said that short-term financing has traditionally been relied upon to finance short-term needs and is not normally regarded as a proper source of long-term financing of capital expenditures or for the refinancing of maturing long-term debts. It expressed its concern "about the use of short-term financing for long-term purposes." On the whole, however, the Penn Central was found to be in a strong financial condition. Then the Commission concluded that in view of the tight money market and PRR's stated intent to negotiate long-term financing as soon as feasible, the application should be approved.

By late 1969 the ICC knew of Penn Central's service deficiencies and financial problems. Several informal meetings were held, but, except for the May 1968 order requiring performance and status reports, the Commission undertook no formal or informal action of overview until after the bankruptcy in June 1970. What continuous and thorough overview could have achieved is an interesting subject of inquiry for imaginative minds. Where specific governmental approval is required by law to merge corporations and their properties engaged in providing service of critical public importance such as transportation, the duty of overview must certainly fall on some authoritative body. The responsibility for approval of railroad unifications is vested in the ICC and carries with it the duty of overview.

In the post merger period prior to bankruptcy, the long-time atmosphere of conservative policies characteristic of the PRR for over a century seemed still to affect the public view of Penn Central. Except for an on-the-ground inquiry used to produce a financial analysis for brokerage houses, no outside group made any significant investigation of Penn Central and the merger results prior to the critical days in the spring of 1970.

Private Processes

The C&O–B&O union set in motion a train of events leading almost inexorably to the ill-starred Penn Central combination. Although many questions surround the demise of this company, the abortive merger was, in the revelation of hindsight, a clearly predictable failure. The now surprising blindness to the devastating pitfalls tells much about the merger process and about conventional views of it. No one seemed to realize that some little noticed details were, in fact, critical. Even the merger's opponents focused on the ultimately irrelevant considerations of power concentration, suppression of competition, and diseconomies of scale. They argued that the long term effects were undesirable, not that consummation was impossible. It is now clear that the real question was simple survival.

The merger policy lessons from a case with bare survival the over-riding concern may be limited. But the Penn Central merger offers a shrill warning about overgeneralizing and expecting the next to be like the last. The real problems were not assessed because they had never been combined critically. We seek a judgment about the processes of merger conception, preparation, and implementation. Assessing reasons for the merger failure is fundamentally different from examining the causes of bankruptcy, although they are certainly related inquiries. The abortive merger attempt is but one contributor to the fiscal crisis.

Much of the merger's tone was supplied by its inheritance, the legacy of the past which helped to condition the character of the merger partners. Their most common feature was utter physical and financial exhaustion and their many differences did not offer compatibility. They were far apart in such major and diverse factors as the types of traffic favored; policy orientations to operations, pricing, and marketing; views of non-rail interests; budgeting, accounting, and reporting systems; and even such less tangible factors as internal and external images and their roles in the community. Major executives were poles apart in attitudes and approaches to most business problems. These cleavages critically weakened planning and were a serious implementation drag.

Merger planning problems exacerbated the barriers to successful consummation imposed by the physical and financial weaknesses of the companies. While receiving extensive attention, planning was essentially *pro forma* and incomplete, concentrating narrowly on traffic rerouting and forgetting most other requirements. But even more critical was a lack of concern for the methods and processes for achieving the integration. The incomplete planning reflects other characteristics and weaknesses. Conflicting philosophies and other incompatibilities prevented advance agreement on many subjects. As a union of ostensible equals with no dominant authority, conflicts remaining unresolved were simply swept under the rug to avoid any signs of friction which might jeopardize the merger's approval.

With all of the difficulties engendered by congenital weakness and ineffective planning, a thoroughly abortive implementation effort is predictable. The extreme financial debility led to a forced draft and premature effort to fully

consolidate the operations of the two companies in order to reach the pot of gold with minimum delay. Financial starvation made the merger benefits an urgent necessity and paradoxically rendered the companies incapable of pursuing them. The extreme disruption and heavy cash demand of these adjustments were neither anticipated nor tolerable.

Given a pair of impoverished and incompatible merger partners embarked on a crash consolidation course, all essential interfaces must cave in. Integration failures ran down the line, involving management and personnel at all levels, facilities, operations, and communications and information systems. These are the final failures that shoved the victim over the bankruptcy cliff. The new company simply did not have the vitality to survive the internal shock created by consolidation's functional disruption as intensified by the uncongenial relationships. Sheer financial desperation dictated the abortive effort to short-cut viable unification processes. Critical financial problems, a merger heritage regardless of their source, not only encouraged self-defeating haste (and waste), but also denied the staying power required for recovery from the shock.[68]

The effects of the merger process itself on the Penn Central are also part of the accounts. The long delay before approval required the companies to operate awkwardly as independent entities while simultaneously assessing the probabilities and effects of union in some indefinite future. This ambivalent situation had adverse effects on both operating and fiscal policies and therefore on company posture at merger time. As one critical example, the need to maximize short run earnings to protect the agreed ratio for exchanging stocks stretched accounting principles, dictated intercorporate relations with subsidiaries, and was then carried forward to infect investment and maintenance policies. And to compound these ill effects, the merger took so long that the economic setting completely changed during the gestation period, transforming company earnings from favorable and rising to depressed and declining. An initially friendly climate for effecting the merger became over these years fatally hostile.

The fiscal policy implications of the merger requiring the PRR to dispose of its N&W stock, a prime source of cash, are also part of the story. The urgent need for high payoff substitute investments partially led to the controversial diversification effort. The concept of merger conditions imposed by the Commission also is of great consequence in this case. Of particularly critical fiscal impact is the forced adoption of the hapless New Haven.

The Penn Central merger failed to clear the integration and digestion hurdles with the margin required for survival. Since the companies failed to meaningfully merge prior to the bankruptcy, few observations can be made regarding the ultimate fruits of the merger. It is certainly impossible to base evaluations of the merger on the consummation failure, particularly conclusions regarding the economies of scale. Some light is thrown on this matter, however, by the limited post bankruptcy success in returning service levels and costs to normal limits corresponding to and in some cases superior to pre-merger standards.

Establishing the irrelevance for this evaluation of merger induced scale diseconomies does not suggest that size considerations are unimportant. Consolidation entails a vast set of interlocks and requires continuous seams to join the combining elements. Size undoubtedly increases complexity at an accelerating rate. Establishing threshhold connections for continuous functioning imposes staggering problems when both components are very large, requiring extremely effective planning and ample time and resources to support the digestion process. The minimal requirements were luxuries the Penn Central was denied.

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[68] The casual coin also has an interesting inscription on the other side. In a sense, money shortages and probably even the condition of the plants were not as critical as the clumsiness of the implementation efforts in greasing the toboggan slide. The operational collapse documented by the Commission's Bureau of Enforcement reports important cases where yard facilities proved to be inadequate for the combined traffic, contrary to the expectations of underlying operational plans. These problems appeared at a number of places including Indianapolis, Toledo, Buffalo, and Selkirk, but only at Selkirk was a planned capacity increase held up for lack of money. Most of the classification, routing, interchange, and car tracing problems were rooted in procedural and personnel failures featuring a supervisory breakdown and compounded by an expectable decline in morale. The ultimate trap, however, was the forced draft philosophy which was both dictated and defeated by financial stringency.

Monetary Impacts

A short run assessment is relevant, since the primary interest is in the bankruptcy. As previously indicated, the longer term effects have not yet been fully felt and will probably never be more than remotely measurable. But the short run balance of costs and benefits is expectedly most unfavorable. These results must be placed against a backdrop of anticipated annual savings of $81.2 million before income taxes and the cost of employee protection attainable within eight years after consummation.[69] The savings were predicated on capital improvements amounting to $74.7 million spread over four years partially offset by a five year salvage and excess property disposal program to net $44.8 million.[70] As a result of the forced draft merger approach, the four year capital budget was exceeded in the first two years, totaling $90.2 million. Of this total, $39 million was for the Selkirk yard, originally estimated at $19.7 million, and $22.4 million for a new classification yard at Columbus which had not been planned.

Including other types of drains, the merger induced cash outlays through 1969 totalled $250.1 million, consisting of the following:

	Millions
(1) Capital improvements	$90.2
(2) Excess per diem	15.0
(3) Lost income	16.7
(4) New Haven advances	14.0
(5) New Haven rehabilitation	31.0
(6) Labor protection	64.6
(7) Purchases of homes; training; excess overtime	18.6
Total	250.1

According to this summary, the operational foul-ups cost something over $30.0 million, a surprisingly small 12 percent of the total. About the same proportion went into the resurrection of the New Haven.

Over this same 23 month period, company records claim merger savings totalling $73.9 million. They are said to have reached an annual level of $52 million in the second year. The total includes $9.6 million attributable to the New Haven, leaving an annual balance of about $42 million on the basis of the planned consolidation. The net cost of the New Haven inclusion is placed at about $19.4 million for the two years.

Including New Haven effects, the net balance attributable to the merger in the two years prior to bankruptcy is a cash cost of about $176.2 million. To put this amount in perspective, it compares with $98.8 million in cash dividends, and $72.3 million for passenger service losses.

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[69] 327 ICC, 673.
[70] *Ibid.*, at 683.

An Integrated View

APPROACHES TO RETROSPECTIVE EVALUATION

Since it is relatively straightforward—but not necessarily helpful—to simply point out past mistakes, serious evaluations based on hindsight must be carefully considered if they are to faithfully serve policy purposes. Realistic performance standards must be established in order to yield generalizations that can be further translated into policy principles. The emphasis placed on "decision constraints" in the preceding examinations indicates that for purposes of this study, evaluation must extend both to management and to the institutional environment in which it operates.

Business firms may manifest a set of goals or objectives with varying emphases, but the fundamental drive underlying all others is certainly long-term survival. There comes a time, however, in the lives of firms that are sick or close to the brink of failure when the tests of short run solvency must be passed. In looking at the Penn Central, it is clearly desirable to keep in mind this distinction between long run survival and short term solvency.

Unless the interest is purely exposé, it is also desirable in the evaluation process to maintain standards of judgment which are precise but above all realistic. While it is interesting to know or to speculate if the "right" path was chosen at a critical fork in the road, it may be more useful in plotting a road map for others (and for policy guidance) to consider whether the choice was a *reasonable* one. If there is an acceptable destination on each path, the map should not close off either one but might lay down the circumstances in which one might be desirable. Unless these circumstances can be stated in absolute terms, the reasonableness test seems more appropriate than the absolutism of right or wrong.

These categories of survival and solvency, and of rightness and reasonableness, may be alternatively joined to produce entirely different evaluation standards. Testing an action in terms of whether it was right for short term solvency or reasonable for long term survival produces quite distinguishable views.

SYNTHESIS OF THE ARGUMENTS

The preceding discussions of the events and forces involved in the Penn Central story are characterized by complex interrelationships, including:

(a) A hostile environment, with its roots in the flabby economic base but compounded by intensifying competitive pressures, dictated financial stringency.

(b) The financial stringency induced operating weaknesses both directly and by adversely conditioning management performance.

(c) Operating weaknesses and associated impairment of managerial performance further contributed to the financial stringency, although the precise weight of their influence cannot be assessed.

(d) One manifestation of impaired management performance is the inability of the main policy areas to provide mutual support. Fiscal policy must provide resources to support plant facilities required for efficient and effective operations and operations must produce outputs that can be profitably priced and sold. Both linkages failed.

(e) The financial stringency also spawned the ill-fated merger which was adversely affected by management performance and which in turn fatally en-

hanced the stringency and established an inhospitable environment for management performance.

These factors and relationships will be spelled out as a step in the search for policy prescriptions.

Throughout the last decade or more, the managements of the Pennsylvania Railroad and of the New York Central Railroad were confronted by extremely tough challenges that were unusual even for the hard pressed railroad industry and far exceeded those generally imposed in other sectors of the economy. To compound matters, the economic structure of the railroad industry makes its firms peculiarly vulnerable to hostile environments. Because of the large fixed investment and associated fixed costs, growing traffic volume is of great significance not only for revenue considerations but also because of its effect on controlling unit costs. This is particularly true when input costs are moving up rather sharply as a result of inflationary pressures. Under these circumstances, a railroad not enjoying fairly marked traffic increases is peculiarly vulnerable to inflation since it has no "absorption" capacity. In addition, much plant investment involves indivisibilities which require the provision of elements of plant capacity beyond current requirements. It is therefore extremely important to maintain fairly regular and rapid traffic growth to keep unit costs under control and to provide investment payoff schedules which satisfy capital budgeting criteria.

The hostile environment was produced by several inter-locking forces. Compounding a generally sluggish economy was a decline in the role of transportation relative to economic activity, indicated by the failure of railroad intercity ton-miles and freight revenues to keep pace with GNP and National Income expansion. There were also changes in the composition and technological mix of the economy, characterized by the substitution of outputs with reduced transportation demands like lighter weight materials. Modifications in production technology and in public demands and tastes were particularly restrictive. A primary case is the marked decline in the use of coal for electricity generation, with the greatest impact on the high-sulphur coal that is principally produced in areas served by the PC. These and other forces spelled pervasive loss of position of the railroads compared with other modes of transportation. All of this hit the Penn Central companies particularly hard, constraining their potential and intensifying the challenge to management at a time when the demands of the merger were also posing peak burdens.

Railroads under these circumstances are prey to many vicissitudes, certainly to recessions and even to "acts of God" and other events (remembering Erie-Lackawana as one of tropical storm Agnes' drowning victims).

Because of its crucial contribution to the story it is desirable to review in some detail the specifics of the environmental forces. During the 1960's, real GNP increased at an annual average rate of about 4 per cent, with considerable cyclical gyration involving recessions at the beginning and end of the period while sandwiching in a period of fairly rapid growth. From the effective date of merger in 1968 until bankruptcy two years later, the economy was in a serious slump, with 1966–70 GNP growth averaging only 2.4 percent per year.

Intercity freight transportation has been a declining share of GNP in recent years. Measured physically, transportation ton-miles increased 43 percent from 1960 to 1969 while real GNP rose 49 percent. In revenue terms the contrast is more marked. GNP (in current dollars) was up by 85 percent over 1960 to 1969, but intercity freight revenue advanced by only 61 percent. Freight revenue per dollar of GNP and per dollar of National Income fell by about 12 percent. The underlying explanation is substantially attributable to the changing mix of the economy, with the services/government/finance sectors increasing at the expense of the mining/agricultural sectors. The latter have traditionally generated substantial transportation, especially for the railroads, while requirements of the former are very modest.

The railroads have lost considerable position among the modes, in terms of volume and even more as measured by revenues. The rail share of traffic fell from 44 to 41 percent during 1960 to 1968, with the truck share holding constant. The railroads' share of freight revenue, however, fell by six points (from 28 to 22

percent of the total) while the truck take rose from 62 to 69 percent. Truck tonnage in 1969 was double that in 1960 (truck revenue advanced 2.4 times) while rail haulage was up 16 percent. This considerable advance in the truck yield and railroad decline reflected the intermodal shift in higher rated commodities from rail to truck.

The Eastern regional perspective is even more dismal. The PC area, consisting of 11 states,[72] in most measures has in recent years lost ground to the rest of the country. Its share of total population fell from 44 to 42 percent from 1950–1969, while value added by manufacturing fell from 65 to 54 percent.

The impact in the East and especially on the PC has been the most pronounced in coal which accounts for the largest share of Eastern railroad and PC tonnages and revenues. It produced in 1947, 46 percent of Eastern railroad tonnage and 42 per cent of PC's but only 33 per cent of all Class I movements. The Eastern roads received 29 per cent and PC companies 22 per cent of revenues from this source which produced 17 percent for all Class I. By 1970 coal's tonnage share had fallen to 39 percent for the East, 34 percent for PC, and 25 percent for all Class I while revenue proportions dropped to 24 percent, 15 percent, and 12 percent.

These changing relationships reflect the sizeable changes in total production and especially in its geographical sources. United States coal output fell by 16 percent from 1957–60 and then rose, but much less in the PC area than in the country as a whole. During 1965–1970, coal production rose by 16.3 percent nationally, but by only 5.3 percent in PC territory, both because of its high sulphur content and the sharp jump in minehead generation (by 200 percent from 1960 to 1970). Pennsylvania's share of national coal output fell by a third in the last 15 years while Kentucky's jumped by half.

Consistent with these trends, coal tonnage of Class I railroads increased by 2 percent, 1965–1970, but the Eastern roads declined 8 percent and PC's 19 percent. Revenue trends are even more dismal during this period. Although Class I revenues advanced by 20 percent and Eastern roads by 5 percent, PC's dropped 11 percent. PC held onto its share of Eastern coal tonnage (23 percent in 1970, 26 percent in 1960, and 25 percent in 1957), but the East generally lost ground in coal production and transportation.

In two key industrial goods areas—steel and autos—the Eastern roads and the PC have fared much better. The PC area's production shares remained stable during the 1960's. After a steep traffic loss in the late 1950's, the railroads' tonnage share also remained level. Revenue increased, however, in response to rate advances after 1965, with PC's 1965–70 steel products revenue rising by 29 percent compared with 4 percent for all Eastern district roads and 1.5 percent for all Class I. Railroad auto traffic gained impressively in all areas during the early 1960's when the introduction of rack cars coupled with aggressive marketing cut deeply into highway transport. The PC participated in this upsurge, although its revenue gains were less than for the railroads as a whole. From 1965 to 1969 the railroads lost auto tonnage (13 percent for the PC and 7 percent for all Class I roads) but PC revenue on this traffic was up 27 percent and all Class I 44 percent.

It is in comparison with truck performance, however, that the relative loss in position of the PC and the other Eastern roads is most vividly portrayed. With 1957–59 as 100, Eastern railroad revenue advanced only to 109 by 1969, languishing under 100 from 1958 through 1965, rising only after 1967 in response to rate increases. Truck revenue concomitantly rose to 165 as higher-valued products, especially in small shipment sizes, shifted from rail to truck. The virtual disappearance of less than car load traffic (LCL) by rail was abetted by increased emphasis on speed and flexibility in distribution systems. For about all the Eastern production areas in the Census of Transportation, the railroads' ton-miles dropped during 1963–1967 while the truck volume rose. While trailer on flat car piggy backing (TOFC), and to a lesser extent forwarder and shipper association traffic, increased, the gains in these categories have been insufficient to offset the shift in smaller shipments of higher valued goods.

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[72] Massachusetts, Connecticut, Rhode Island, New York, New Jersey, Pennsylvania, West Virginia, Michigan, Ohio, Indiana, Illinois.

These disabilities are crowned by the legacy of disputed inter-territorial revenue divisions. This matter has been swamped by controversy over ultimately irrelevant cost measurement questions and then virtually drowned under the oppressive weight of procedural delays which favor the status quo. While the controversy has not been solved and may indeed be insoluble under present processes, the amounts at issue are considerable, particularly according to the scale of values attached to short term survival. In its dying days, in fact, the Penn Central was required to shell out to the far more opulent Southern roads $11.6 million. Relative cost criteria suggest Penn Central divisions might be justified in receiving nearly an additional $50 million in amounts representing undiluted contributions to net railroad operating income (NROI). At an 80 operating ratio, it takes $250 million gross revenue to achieve this net, or a neat $2.5 billion over the study period. In terms of this amount, the diversification program's potential, if any, is not of great significance.

But the principle is more important than the cash for study purposes. What kind of a system can leave such critical amounts so up in the air, subject to protracted delays and capricious answers? This clearly untenable situation requires answers which are consistent with system requirements rather than esoteric cost measurements.

Despite these unfavorable influences and pressures, the early 1960's through 1966 was a period of hope for both companies. Most financial and operating measures were improving on remarkably similar profiles. The ultimate net income results of these favorable trends were distorted, however, by the capitalization of maintenance expenditures, the switch to equipment leasing, and the "earnings maximization" policy. The first two were substantive changes which directly affected NROI. Leasing, in effect, switched interest payments on equipment to the rail operating expense category to reduce NROI, while maintenance capitalization switched maintenance out of the operating expense category and increased NROI. Both were essentially neutral for net income. Earnings maximization, on the other hand, was an accounting-reporting maneuver that had little effect on NROI but overstated net income. In real terms, therefore, the post-1966 situation was relatively more disastrous than appeared on the surface.

The extreme financial stringency was the basic conditioner of fiscal policy, limiting the amount of discretionary funds for disposition, shaping capital budgeting decisions, and dictating financing options. PRR fiscal policy was rather consistently governed by a set of priorities and criteria built on maintaining the credit standing of the railroad if possible, but particularly of the Pennsylvania Co. (Pennco) as an inviolable line of credit defense.

Fiscal policy concern centers on what was done with the money and how it was raised. The main dispositions of interest are investments in the physical plants and in outside businesses (diversification) and dividend payments. Money raising questions focus on the uses of debt and equity financing, equipment financing, and postmerger short-term financing. The whole complex of activities is shrouded by the mysterious earnings inflation reporting which created a growing gap between reported earnings and cash income, a difference conservatively estimated at around $46 million in 1968 alone. This practice, which necessitates careful interpretation of the usual fiscal indicators, was successful in achieving management's purpose of deluding both private and governmental outsiders, but it also harmed the subsidiaries and sacrificed some cash-raising opportunities.

The fiscal processes of both railroads allocated plant investment funds rather generously in terms of fiscal capacity as measured by earnings, particularly as manifested in the Pennsylvania's contributions to equipment. The allocations for both investment and maintenance for roadway and equipment were relatively light, however, compared with neighboring carriers in terms of physical units operated.

The PRR embarked on a last ditch investment-maintenance effort in 1964–66 which failed to meet payoff expectations of the financial officers. There are two sides to this important story: (1) Finance claimed that project submissions by operations were poorly conceived and supported. Comparative operations analysis confirms limited capability for payoff yields, particularly under the yoke of damaging traffic trends. There is also little indication in the

operating performance data of performance sensitivity to changed levels of plant investment, (2) On the other hand, the payoff expectations associated with the 1964–66 program far exceeded those realized or even anticipated in diversification ventures. The record does not show the actual return realized from these projects or even that an effort was made to measure it. It is also noteworthy that the immediate payback requirement imposed on rail investments was not applied to diversification by the management. Accordingly, the capital budgeting picture is unfortunately clouded.

The Pennsylvania had a long and successful tradition of outside investments and had come to depend on them in the total fiscal pattern. With the sale of the Norfolk and Western Railroad holdings imminent, the Pennsylvania sought new outside investments. From the standpoint of the railroad's cash needs, the portfolio was poorly selected since the dividend payouts of the companies acquired were severely limited by their own cash requirements. But given management's interest in preserving or improving its image in financial circles, the earnings maximization policy combined with the real estate investments was highly successful. Management could show impressive earnings from the non-rail investments thereby conveying a corporate image having little relation to the facts. But while the actual return from these investments was not imposing, it was not until after the bankruptcy in 1970 that the real estate development subsidiaries recorded their large losses. Diversification did drain millions of dollars from the railroad, but by itself could not have retarded rail operations enough to jeopardize long run survival. In fact, it probably prolonged the struggle, obscuring the desperateness of the railroad's own earnings situation and deferring the final showdown and collapse. The desirability of this contribution is clearly debatable.

The bank loans arranged by the parent company for its nonrail subsidiaries had little effect on the lines of credit which could have been used to forestall bankruptcy. The railroad relied basically for credit generation upon the Pennsylvania Company whose assets were largely in the stock of nonrail subsidiaries. Loans to improve the operating performance of the subsidiaries represented an attempt to increase the value of the railroad's only pledgable assets since nearly all of its own were tied up as collateral for prior loans.

But the diversification program's relationship to short run solvency must also be clearly noted. The total amount laid out over the six years constituted a cash drain that contributed to the ultimate crisis and collapse, although it must be placed in perspective. The net amount of this drain (about $48 million) over a period of six years was small compared to other crisis contributors. But here again the amounts may be less important than the principle. The gross outlays generally used to evaluate quantitatively the diversification program includes the amounts invested, with the implicit judgment that the funds should have been kept on hand as cash or that the investment should not have been made unless it promised immediate recovery. It is true that when short term solvency becomes the issue the ultimate payoff is not relevant. On which wave length should the management have been tuned in? Is it better to sit back hoarding your meager resources and waiting for a miracle (which experience suggests won't happen) or to use the limited available resources to try to break out of the bind? The bolder approach is certainly a reasonable one even if unsuccessful. But the question remains as to the nature of that approach—the fact that the action taken is bold and reasonable can still leave doubts about the wisdom of selecting one non-rail investment over another or even over more investment in the rail plant itself. The answer depends perhaps on whether one wishes to be more responsive to public needs or to stockholder interests. Clearly, it can be concluded that whatever might be reasonable action by management, diversification cannot be relied upon as a private remedy for railroad difficulties. From a transportation policy standpoint as well as that of the private investor, transportation company failings should be exposed under bright lights so that the proper treatment can be applied. This cannot happen when the true picture is obscured behind a facade of glamorous financial ventures.

Although PRR and NYC dividend payout rates did not exceed the railroad system rates, the companies' rates are understated because of reporting dis-

crepancies which include particularly PRR's exaggeration of income through its "earnings maximization." The high premerger rates are generally attributed to, but certainly not justified by, defensive requirements imposed by the stock exchange ratio of the merger agreement which generated something like a "dividend war." A continuing motive going beyond the merger is a desire to maintain both stock price levels and a general atmosphere of credit worthiness. Payments through 1966 were made against a backdrop of favorable trends. It is difficult, thereafter, to understand the large payments as a means for maintaining credit standing. Railroad dividend rates generally are too high and for the Penn Central they were extraordinarily high. They were clearly unwarranted in the light of the impending doom and in the light of management's disinterest in raising money through stock issues or other equity financing. These payments were also wrong in terms of their impact on short term survival.

The debt reduction programs were reasonably dictated by concern for earnings and the ability to cover fixed charges and upcoming maturities. Debt-equity ratios, particularly for the PRR, were low compared with the industry as a whole, seeming to imply that the costs of capital could have been reduced by greater resort to borrowing. The ratios were understated to some degree because of the increasing use of equipment leasing in lieu of equipment trust certificates. But the comparison also demonstrates the anomalies arising from the continuing financial stringency suffered by the companies. Even if the debt were low relative to equity, it was still high relative to income and the associated ability to cover maturities and fixed charges. This basic income insufficiency together with high down payments required for equipment trust financing encouraged the Central's switch to conditional sales agreements and the Pennsylvania's to equipment leasing.

The pressing difficulty with debt suggests that consideration should have been given to an equity issue, particularly in connection with the buoyancy and optimism generated by the merger approval. When that possible opportunity was ignored, plans for alternative long-range financing might have been implemented. Failing this, the last resort was the short term borrowings which were clearly but manifestations of *rigor mortis* and should have been recognized as such, particularly by the Interstate Commerce Commission but by other interests as well.

Evaluation of managements' operating performance is complicated by several factors. It is influenced by the character of the plant available. The quality of the operating tools was severely restricted for both the Penn Central companies by the debilitating financial stringency which was intensified by the cash outflow for dividends, real estate, and merger startup costs. Operating with this handicap is bound to be reflected in performance measures. Traffic trends and patterns partially beyond the control of operating management also influence usual notions of "efficiency." And some aspects of managerial performance, as in pricing and marketing, thoroughly defy rigorous evaluation because of vague and unmeasurable criteria.

Plant and traffic conditions did conspire with management defects to produce performances by the Penn Central and the component companies generally inferior to the achievements of their neighbors, connections, and competitors. Managerial contributions to the record of performance deficiency were indicated by ineffective labor utilization. Management cannot escape responsibility for traffic losses which are at least partly attributable to the conscious decision not to compete for less than carload traffic, to poor service and to increasing rates in the face of poor service. Each partner shared the weaknesses which produced the unfavorable results, the Central falling prey more particularly to unfavorable traffic patterns and the Pennsylvania to plant weaknesses.

In most respects, the Central came off the better in the performance measures. But in the last analysis, there was little difference between them in terms of the ultimate performance measures or associated financial results. This outcome suggests the importance of elements other than management efficiency in the companies' financial collapse. Furthermore, the two companies were strong competitors for much traffic. It is eloquent testimony that there was no discernible tendency during the 1960's for competitive shippers to switch to the Central.

"Management performance" is not a monolithic concept but is rather neatly compartmentalized into fiscal, operations, and pricing/marketing policy categories which are highly interdependent. The character of the operating plant depends partly on the processes of fiscal policy. The payoff on capital investment programs depends on the effectiveness of operations and pricing-marketing activities. The success of these programs depends on the quality of the service outputs supplied by operations. It appears that these major areas were not mutually supporting. Fiscal programs failed to provide tools adequate to produce completely marketable services. On the other hand, operations was not able to generate, or marketing to sell, services required to meet capital cost criteria. The lack of coordination particularly after merger, but before as well, was a serious management failure. The most discernible management goal in the 1960's was merger and after that event management was preoccupied with crisis response. All of this is certainly a definition of a failing enterprise but not the sole cause of it.

Railroad mergers generally hold out the prospect of economies and improved service quality; the fears are adverse effects on competition and on service levels. The merger process is a classic manifestation of the "domino theory." Each merger makes succeeding ones more urgent and yet severely and progressively restricts options.

In retrospect, the wild postmerger debacle which included service breakdown and final financial collapse was not primarily an aberration reflecting managerial frailties. More properly, the breakdown was the outcome of a set of developments stemming predictably from the major premises of the case. Unquestionably management did not meet its responsibilities and could have been more effective, but under the circumstances success for this railroad in the Northeast would have required an unusually broad base of especially effective management talent which no company can be counted on to have. The roots of disaster were embedded in the attempted union of two fiscally emasculated and operationally incompatible equals. One of the management's prime errors, shared by others as well, was in not recognizing the realities of this merger. The resulting miscarriage brought forth a grotesque set of Siamese twins. Positively stated, the ingredients for a successful merger include diverse but complementary partners with fiscal strength and premerger authority firmly lodged in one of them.

Penn Central screams that merger results are unpredictable and may indeed be devastating. But more quietly it proclaims much more—the bankruptcy not only of the company but also of a dominant idea about railroad mergers. This defunct idea is that mergers are really and ultimately an institutional iron lung—an artificial resuscitation device for expiring railroads. The Penn Central is the ultimate corruption of the merger process. Any improvement in the applicants' financial outlook during the litigation brought contentions that the merger was no longer "needed." The best answer to this blue sky contention is "so what." Instead, it was given back in kind—defending the merger on the irrelevant grounds that conditions weren't as favorable as they seemed. Penn Central points up the now obvious paradox that wrecks the resuscitation rationale. The more justified the merger, the more certain its failure. If only partly justified on these grounds, it will only partly fail—as in Erie-Lackawanna which has just gone under.

Penn Central—through its merger failure and its bankruptcy—further proclaims the impropriety of proprietary criteria as public policy guides. Penn Central, like others before it, was generated, implemented, and judged—both *ex ante and ex post*—on the basis of Penn Central's income statement. Proprietary fiscal criteria provide an inadequate answer to the vital question of what the Penn Central and its merger meant to the national rail system.

Far from being pure idiosyncracy, Penn Central, as for many other aspects of railroading, provides a view at the far horizon of present merger doctrine. It is the logical culmination of flabby policy. If merger is to have a further place in transport organization strategy it must be predicated on relevant transport systems criteria. Only in this way does it have a chance to avoid taking on some losers and passing up some winners.

CONCLUSIONS

To a large extent long run survival was jeopardized by forces beyond the control of management which also conditioned management unfavorably. A basic force was the adverse market trends which weakened the industry as a whole while operating with particular severity on the Penn Central and its companies. In most cases little can be done by the management of a single railroad about the crippling trends. Penn Central should force a basic assessment of the relevant role of railroads in today's economy and more particularly press the generation of viable criteria and devices for insuring the effective delivery of the most appropriate form of transport service considering the country's needs, ecological considerations, sociological and economic factors.

While accommodating policy to market realities we must also examine the influence and effectiveness of institutions that are subject to control. The inept hand of regulation has left its fingerprints all over the setting. The mere fact of bankruptcy places regulation as practiced by the ICC under a cloud equally as black as the one shadowing management. The general and growing criticisms of the ICC's brand of passive regulation urgently require a close, critical, and *actionable* examination in the light of the Penn Central history. The degree of culpability or the effects of ICC actions in such areas as joint rate divisions, competitive price control, general rate cases, or car supply cannot be determined without that examination. But there are also some specifics in the bill of particulars, starting with the patent bankruptcy of regulation's approach to railroad mergers.

Given its environment, management performance, aside from any outright wrongdoing, was reasonably predictable. No one of its mistakes was by itself either critical for long run survival or catastrophic because of any contributions to short run insolvency. In the absence of basic institutional reform, there was little to be gained from management's principal concern in the later stages of keeping the railroad barely afloat for a more extended period. Losing control of their movements like the banana peel victim, the Penn Central giants, barely alive but still breathing, were a real nuisance. As casualties, however, they can serve a profound public purpose as the catalyst in forging realistic approaches to transport policy.

The policy implications of these broad lessons of Penn Central are explored in the conclusions and recommendations of the report. There are some matters of detail that should not go unnoticed, but it is important to avoid symptomatic responses. For example, while the diversification program had some unpalatable aspects, blindly prohibiting or limiting this movement is a far cry from the urgently needed design of effective policies for transportation service.

REPORT CONCLUSIONS

What Happened to the Penn Central?

The Penn Central debacle is not an isolated idiosyncratic event solely attributable to individual misdeeds or to singular financial manipulations. The Penn Central collapse signals the inability of present public and private institutions to provide a stable and adequate rail service for a major region of the nation in an adverse business environment.

Whatever responsibility may be assigned to the management of the Penn Central and its component companies, they were not the creators of the hostile market conditions that plagued their operations for years. The central question in evaluating the managements is really their response to adversity, particularly as that response was conditioned by the forces of public policy. The study did not reveal evidence of financial speculation or manipulation of sufficient magnitude to have been the sole cause of the Penn Central's fall. While there was speculation, management conflicts of interest, and perhaps illegal activities, detrimental to the fate of the Penn Central, such activities were not on the order of magnitude of the great financial scandals that have marked the history of the rail industry nor were they major contributions to the collapse.

The study shows that the cause of the Penn Central bankruptcy is to be found in the complex interaction of a number of factors including questionable management policies, misdeeds of individuals, Federal regulatory policies and practices, inadequate public policy toward transportation, the national economy, peculiar business conditions in the Northeastern part of the United States, flaws in the private sector's structure and response, changing demands for rail services, and successful competition from other modes of transportation.

The foregoing represents the principal conclusion of this report, i.e., that a combination of factors brought about the Penn Central's demise. But it is important to evaluate each of those factors and while doing so to place in perspective the contributions of the hostile environment and the respective performances of the public and private sectors. What follows is a brief review of the principal contributors to the Penn Central experience.

The economic environment.—During the 1960's and before, the Penn Central found itself in an environment where the national economy was changing, reducing the importance of the principal commodities carried by railroads and therefore their role in the transportation system. Most railroads were affected by technological changes including the use of lighter weight materials, by the usual cyclical economic patterns, and by competition from other modes. But the Penn Central, and others in its region, had peculiar problems because the environment for railroads in the Northeast was worse than elsewhere. Coal production declined, railroads failed to compete successfully for the increasingly important manufactured goods traffic, small shipment traffic was lost, and the situation in interterritorial divisions remained static. These factors combined to make survival of railroads in the Northeast, without private as well as public changes of policy, much more difficult than had been the case previously. The situation continued to grow worse throughout the entire merger gestation period and after bankruptcy.

Fiscal policy.—The Pennsylvania Railroad was confronted by a large burden of debt with heavy maturities in the mid and late 1960's. After 1964 its liquidity, providing the margin of safety needed for successful debt management, was practically non-existent. The result was deferred maintenance and reliance on leasing to obtain necessary equipment. The Pennsylvania had begun relying heavily on equipment leasing in the late 1960's and the Central had adopted a similar program in 1962 to help maintain the merger established

ratio as between the values of Pennsylvania and the New York Central stock. Extensive use of leasing made it possible not only to reduce (effectively understate) fixed charges but also to avoid high down payments in the early years of equipment use (unfortunately at the expense of higher payments in later years). The Pennsylvania and later the Penn Central undertook a concentrated effort of maximizing earnings, i.e., using every device to inflate and overstate figures so as to report the highest possible earnings. Partly the result of management's desire to protect the 1.3 to 1 stock exchange ratio agreed upon with the New York Central in 1962, it completely distorted the earnings picture and distorted management effort so that the generation of cash actually became of secondary importance, in many instances, to the inflation of reported net income. Coupled with the policy of maximizing paper earnings were extraordinarily high dividends paid out by the merger partners between 1960 and 1969, representing a severe and completely unjustifiable cash drain on a company badly in need of cash.

Financial stringency and the concern for maintaining credit standing helped produce an ad hoc policy of compromising conflict which presided over a deteriorating rail plant while overstating earnings and paying excessive dividends. The fiscal policies of the Penn Central and its predecessors created an illusion of strength that hid from public view the extent of decay.

Diversification.—It was at first suspected that the diversification program of the railroad (investment in enterprises outside the traditional areas of railroad operation) was the single most powerful force undermining railroad performance. Closer analysis showed, however, that diversification was a relatively small factor when compared to others such as dividend policy and when measured in terms of cash drain on the railroad. It certainly could not be singled out as the sole cause of the collapse. Indeed, the theory of diversification may have been a reasonable business response to the circumstances confronting the railroad when the program was begun. As carried out by the Penn Central it combined with other fiscal policies to artificially prop up the company's credit standing. It also appeared to be of short-run benefit by clothing the railroad in the glamour of the conglomerate fad. There can be no doubt that diversification took badly needed cash out of the railroad that could have been used for maintenance, and other railroad needs. From 1963, when the modern diversification program was instituted, to the collapse, the cash outlay was $193.8 million. Of that the Pennsylvania paid out $172.21 million, the Central $21.4 million, and the Penn Central $6.7 million. Subtracting from the total outlay the cash received from these investments and subtracting also the cash received from sale of stock in the Norfolk & Western and Long Island Railroads the net outflow was $41.8 million. While not a significant amount when compared to the $1.5 billion put into the railroad between 1959 and 1967, in absolute terms it was still substantial. Granting all of the arguments in favor of diversification as a policy for sustaining railroad operations, the Penn Central's implementation of the diversification concept, insofar as the real needs of the railroad were involved, must be judged to have been faulty. Investment was made in projects (principally real estate) that required cash and that had a long payout period, the same cash demands as the railroad's. What the railroad needed was quick return on its investments in the 1960's; instead the diversification program joined with the demands of the railroad and other factors such as high dividend payments to compound the strain on scarce financial resources.

Operational performance.—The physical condition of both railroads was poor prior to merger and continued in that condition thereafter. Accident rates and slow orders were incredibly high, particularly for the Pennsylvania, showing clearly the defects of deferred maintenance which in turn reflected both fiscal limitations and managerial options. Equipment and locomotives were in bad condition and service complaints rose. The Penn Central partners ran significantly behind other railroads in their region in productivity, indicating that labor control was ineffective. Labor costs are quite high still on the Penn Central; the unfavorable pattern developed well before the merger, suggesting that the merger agreement to recall previously furloughed employees may not have

been as significant as inadequate management control of its labor resources. The quality of service continued to deteriorate.

The pricing and marketing techniques of the merger partners were determined by practices of competitors, shippers, and others hostile to major innovations and condoned by a passive ICC. It is important in developing policy responses to keep constantly in mind that the different management techniques of the Pennsylvania and the Central seemed to make no measurable difference indicating the degree of influence of other factors.

A prime deficiency was the non-existence of corporate goals overriding the often conflicting goals at the departmental level. In addition to the merger consolidation problems, the Penn Central lacked coordination and lacked mutual support between the major areas of management.

Merger.—The merger, looked upon by management as the salvation of the railroads, actually contributed significantly to the cash drain, drawing off a total in merger induced cash outlays through 1969 of $250.1 million. Offsetting this by the claimed merger savings produces a net drain of $176.2 million. In addition to the cash impact, the merger contributed much confusion and wasted effort. It is clear that the merger process itself contributed significantly to the decision to enter bankruptcy in June 1970.

WHO IS TO BLAME?

As with calamities that take human lives, there occurred after the demise of the Penn Central, an immediate search for culprits. But with the Penn Central's crisis as with so many others, no individual or small group could be isolated. The causes were many and so were the perpetrators.

In assessing responsibility for the Penn Central collapse, it is necessary to evaluate the failure to take action as well as mistaken and wrongful action. Since both public and private forces were at work in the Penn Central case, it is useful to categorize the actors as public and private forces.

PRIVATE SECTOR

Penn Central Management.—The Penn Central management (and their predecessors on the separate roads) failed on a number of fronts and those failures in sum must be judged to have contributed significantly to the debacle.

As indicated previously a principal management failure was the non-existence of discernible goals for the railroad, and a lack of coordination between various branches of management. Not only was there a failure of coordination between the Pennsylvania and New York Central prior to merger, but after merger the various departments failed to cooperate and to provide mutual support. It seemed that the only mutual goal was to merge the railroads and this narrow focus diverted much of management's attention away from solving the fundamental problems entrapping the railroad. The various management branches failed to appreciate each others' concern. The operations section was dissatisfied with the money made available to it by the financial section; the latter was reluctant to provide more financial support for operations when operations seemed to yield inadequate return and, indeed, to yield poorer performance than other railroads that were spending a good deal less. The pricing and marketing functions did not necessarily take account of the operating capability nor the financial needs of the railroad.

A second deficiency was management's inadequate response to the changing market demands and other circumstances of the railroad's environment. It is generally known, of course, that the Pennsylvania Railroad and the New York Central employed substantially different pricing and marketing strategies. However the two different strategies seem not to have produced significantly different results; thus, it is not possible to judge either as adequate. Or put another way, differences in managerial approaches were not critical. While in the Northeast the traditionally important commodities to railroads were declining in importance, the carriers failed to take advantage of the market for transporting manufactured goods and instead gave it up, along with less than carload shipments generally, to their competitors the motor carriers.

Third, and of great consequence was management's decision to merge the Pennsylvania and New York Central Railroads. Conventional wisdom of the day dictated that mergers produced financial strength. The apparent strength of other merging railroads posed a seemingly serious threat to both the Pennsylvania and the Central. Acting more on blind faith, as subsequent events revealed, than on analysis, the managements of Penn Central's predecessors saw merger as the way to strengthen two sick railroads. Management should be faulted here for not analyzing and evaluating alternative courses of action.

Fourth, merger became such an obsession that the managements were willing to "pay" a considerable amount for the merger. It may be argued that they "paid too much". They took on the loss ridden New Haven as a condition of merger. In addition they assumed labor protection costs, amounting to $64 million in the first two years as it turned out. It must be remembered that the two railroads were not forced to merge; if they believed that the conditions imposed were too costly they could always have withdrawn from the agreement. But withdrawal never seemed to be an alternative and the architects of the merger drove to completion at whatever cost.

Fifth, during the long merger gestation period from 1962 through 1967 management's primary attention was focused on winning the legal challenges to merger and to maintaining, through earnings inflation and other questionable techniques, the relative stock values of the two railroads as established in the merger agreement. This artificial constraint affected the railroads' operations, making the demands of their markets and the interests of the public and transportation secondary objectives.

Sixth, even after the merger was finally approved management continued to compound earlier errors. The decision was made to consolidate operations of the two railroads as rapidly as possible so that the anticipated merger benefits could be realized as soon as possible. Seemingly intent on proving the accuracy of the old bromide that "haste makes waste", management plunged forward with a blueprint describing the end result but had no map available to describe how to arrive at the destination. As a result there was a net cash loss of $176 million which the railroad could hardly afford during these first two years of merger. A recital of symptoms is now familiar: Employees were not trained for new functions, the supervisory structure broke down, conflicting procedures and directions were issued, chaos plagued train operations (created partially by initiating construction projects in many yards at one time and hastily closing other yards), seriously deteriorated service drove customers to other carriers and modes, costs skyrocketed and uncollected revenues were multiplied by billing failures. Management, seemingly believing that such problems were inevitable, came to view their merged railroad as nearly unmanageable. Much has been made of the differences between the Pennsylvania and the New York Central Railroads; the conclusions of the study, however, are that it was perhaps as much management's failure to manage as it was a fundamental incompatibility that led to the disastrous results of consolidating the two railroads.

Seventh, from a public interest standpoint, there can be no justifiable explanation for management's dividend policy during the 1960's. While the study did not turn up direct evidence of a scheme to deplete the railroad's assets for management's benefit, the large and increasing dividends paid during the last years of the railroad combined with the large stockholdings of many of the railroad's officers, suggest actions which bear investigation by appropriate authorities. The dividend policy depleted cash by $307.5 million between 1960 through 1969 ($282 million of that was paid out after 1963), cash desperately needed by the carriers. Large dividends could not be justified by the usual rationale of needing to keep the stock price high in order to attract new capital, because there is no evidence that the Penn Central ever contemplated issuing new equity capital even though opportunities did present themselves.

Eighth, labor utilization was poor. Productivity was low. It seems apparent that inadequate management control of labor was of much greater detriment to the railroads than the post merger recall of furloughed employees.

Ninth, the diversification program, initiated in 1963 by the Pennsylvania and carried out by the merged railroad, produced a net cash loss for

the railroad. It resulted in the acquisition of assets which had long-term payout periods for cash, clearly not the kind of investments that would support a cash short railroad.

Tenth, other factors of fiscal policy, including the earnings inflation program, represented management actions grossly inconsistent with the public interest.

From the shipper's viewpoint and the public's viewpoint these omissions and commissions by management were manifested all too clearly in the completely inadequate service of the railroad.

While a study of the Penn Central results in a strong indictment of its management, it would be a mistake to end the examination with the conclusion that management failures were the principal reason for the railroad's downfall. A different management might have made substantial differences, yet the environmental circumstances surrounding the Pennsylvania Railroad, the New York Central Railroad and then the Penn Central Railroad were so burdensome that it is not easy, nor perhaps valid, to conclude that a different management would have prevented the collapse of the Penn Central (or of their predecessors if the merger option had not been pursued). It would have required many years of effort by above average managers to reverse the downward trend of the two railroads.

Of course, the fact that Penn Central's management cannot be held solely responsible for the railroad's collapse does not excuse nor mitigate their failings. Any violations of law should be vigorously pursued and private remedies should be sought for private injuries.

Rail industry.—Another element of the private sector that bears responsibility for the devastated condition of the Penn Central and other railroads is the railroad industry itself. The rail industry is composed of separate companies dependent upon one another to a degree not found in most other industries. They must interchange much of their traffic with one another and, thus, are mutually dependent for satisfactory performance to their customers. But the rail industry took no action to counter the deterioration of the Pennsylvania, New York Central and other railroads in the Northeast. Rail industry policy, perhaps dictated by stockholder financial considerations, essentially decrees that each railroad take care of its own problems and look after its own proprietary interests.

The railroad industry might have responded differently to some of the environmental conditions that led to the Penn Central's downfall. A greater effort might have been made at mutual cooperation to improve service perhaps through devising methods to handle small shipments profitably. It is possible the industry might have devised institutions for industry investment in and return from those parts of the Penn Central system necessary to maintain the integrity of the Nation's rail network. Undoubtedly it could have developed a system-wide control of equipment usage to help improve utilization and, thereby, improve service while cutting unnecessary investment and huge equipment rentals. Creative and constructive work could have been done in developing a more competitive rate structure. (Instead the industry consistently sought across-the-board rate increases.)

Whenever the industry called upon government for financial assistance it was with proposals narrowly designed to advance the proprietary interests of the companies instead of proposals to advance the interests of the system and to result in improved service to the public. It did not address underlying industry ills. The industry might have earlier called upon government with some objective proposals directed at well known but unsolved system problems such as freight car utilization.

As long as the industry fails to take the systems' approach to its problems and to engage in self-help efforts there will be increased pressure on government to act in industry's stead.

Congress.—The Penn Central bankruptcy reveals long standing weaknesses in government's relation to the rail industry. Congress can be held accountable for failing to face up to these deficiencies. Of course, the basic policy of private ownership and management has dictated abstinence from involvement in the affairs of railroads, except for regulation to protect shippers and the public from abuses. A major conclusion of this study is that Congress should examine government's present relationship to the rail industry and consider extensive legislative changes.

Executive Branch.—The Administration failed to address fundamental problems confronting the railroads and failed to propose remedies for these problems. For example, the Executive Branch of the government withdrew its opposition to the ill-considered merger in return for inclusion of the New Haven Railroad in the Penn Central system. Although such a requirement was consistent with the basic policy toward railroads, i.e. dictating that problems be solved by the private sector, and it is difficult to fault the Administration for attempting to continue service along the New Haven's routes, such an approach to the New Haven's situation again illustrates a failure to face up to the need for reform of government policy. It was an attempt to sweep the problem of the New Haven under the Penn Central rug.

The Department of Transportation failed to spotlight the Penn Central's problems until very shortly (some 15 or 20 days) before the bankruptcy. At that time the Administration, displaying a greater concern for the proprietary interests of the corporation than for the transportation needs of the public, came forward with a cosmetic legislative proposal designed simply to keep the railroad out of bankruptcy. As events have demonstrated, the railroad has continued to operate in bankruptcy (with governmental assistance in the form of $100 million in guarantees of trustees certificates) and it is generally accepted that service has substantially improved. The task was not to keep the company out of bankruptcy, but rather to focus on reforms necessary to continue service. This the Administration overlooked. If the Administration's view had prevailed in Congress, once again the problems of the rail industry would have been papered over and, the numerous misdeeds of management that subsequently came to light would have continued to be shielded from public view.

Interstate Commerce Commission.—The Penn Central case is a docket of dismal failure by the Interstate Commerce Commission. The Interstate Commerce Commission was the principle governmental body charged with overseeing the operation of the rail industry and with protection of the public interests. Other governmental entities failed to recognize a problem and to obtain authority to deal with it; the Interstate Commerce Commission failed to use the authority it had.

First, the Interstate Commerce Commission's merger policy—or rather lack of coherent policy—is faulty. It proceeds on a case-by-case basis with insufficient consideration of implications for other affected railroads in the region or for the needs of the transportation users. At one point in 1962 the Interstate Commerce Commission had before it the Norfolk and Western—Nickelplate-Wabash case, the C&O–B&O merger proposal, and the Penn Central case. The Commission steadfastly refused to consolidate the parts of these proposals, thus avoiding administrative inconvenience but casting the die for a railroad designed restructuring of the entire Northeastern rail network. Given the industry disposition toward mergers, the pattern made merger of the Pennsylvania and New York Central almost inevitable because the roads had nowhere else to go in the Northeast but together. Thus, the Interstate Commerce Commission's approach to mergers laid the groundwork for the improvident Penn Central merger. At the same time the Commission was averring that it had no authority to restructure the Northeast, the restructuring was in process under ICC aegis. The Commission accepted the rhetoric alleging mergers to be the answer to restoring the health of railroads. It did not analyze the fundamental problems of the Northeast nor did it propose solutions. Adopting a purely

passive role, the Commission, for the most part, accepted any transactions proposed by the railroads, requiring only that affected complaining parties receive some consideration of their interests. Section 5(2)(c) of the Interstate Commerce Act seems to require more from the ICC than the role of an umpire.

After the merger was legally consummated the ICC should have monitored the course of the merger but did not. It did not analyze nor insist on accurate analysis by the parties of the cost and benefits of the merger. It did not give any thought to the monumental task of consolidating the operations of the two roads after merger day even though that task was fundamental to the merger rationale. The Commission did not alert the government or the public to the Penn Central's problems and its impending collapse.

Second, a major reason for the unreadiness of a public policy response to the impending Penn Central collapse was the unavailability of vital information. The managers of the Penn Central successfully hid their problem from public view and thereby limited government's capability of responding to a legitimate threat to transportation service. The Interstate Commerce Commission may have prevented this shock to the Nation's nervous system by closely monitoring the Penn Central and by requiring more information about the cash situation of the Penn Central Company. The Commission should have spotlighted earlier the Penn Central's extravagant dividend payments and its earnings inflation policies. It could have examined and perhaps halted the improvident diversification programs.

Third, running throughout the entire picture is the recurring theme of inordinate delay being a prerequisite to any final order by the Interstate Commerce Commission. The problem is not easily resolved in that in any adversary proceeding provisions must be made for insuring that each party has adequate opportunity to be heard. Additionally many ICC orders are deferred by judicial action after the Commission has made a determination. But delay in the consummation of the merger, and in rate cases initiated by individual lines, has had a very grave effect on public as well as on the private transportation industry.

Fourth, the Commission in its numerous activities related to the Penn Central affair was inattentive to service quality. It failed to identify the public interest or to measure the various proposals by that yardstick. It relied upon private resolution of disputes, a technique that is only effective for those wealthy enough or well organized enough to be represented by their own advocate.

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POLICY RECOMMENDATIONS

Prologue

Current public policy is deficient. Government action will be required in a variety of efforts so that the industry is better able to respond to changing circumstances. The present structure and organization of the private sector along with public policy too often fail to meet public needs for rail transportation.

Service improvement must be the watchword and criterion of government policy—service to the shipper and to the consumer generally. The tendency has been to think and to act in terms of financing the industry—such action insures that the structure will not change and past experience suggests that service will not improve. Focusing on service will require a systems approach rather than one narrowly directed to the fate of individual companies or toward resolution of particular crises. Responsible government cannot rely completely on private ordering to obtain public policy objectives.

Introduction

This portion of the report will recommend changes in public policy prompted by the study. The recommendations are offered for public and private discourse. Many of the recommendations would require legislation, many would not, others might require a different set of initiatives. Before being implemented most of the recommendations will require careful examination. Such an examination undoubtedly would produce modifications. But, nonetheless, it seems useful to advance the proposals suggested by the report in the hope that the journey toward improved public policy will thereby be shortened.

No specific recommendations are made herein regarding the application of the Bankruptcy Act to railroads. But that omission is not to suggest that section 77 of the Act should not be changed and, indeed, many of the recommendations which follow could result in some changes in approach. Attention should be given to overhauling the Act so that it provides sufficient authority for addressing transportation problems as well as financial problems.

The recommendations are divided into two main parts; the first part relates to the rail industry generally and the second part to the Penn Central specifically.

Within the first part the recommendations are divided into four main areas:

—Improvements in public disclosure of the financial, physical and operating conditions of railroads.

—Improvement in policy formulation within the government.

—Revision of the relationship between Government and the private rail sector.

—Recommendations relating to specific issues in the rail industry: Diversification, rates, dividends, abandonment, divisions, merger policy, shippers' interest, service, plant maintenance, freight cars, and government assistance.

Recommendations Regarding the Rail Industry Generally

improved disclosure

The Penn Central case demonstrates that while voluminous information is currently obtained from the rail industry by government (primarily the ICC) such information is not completely useful for public purposes. The Penn Central earnings maximization, or earnings inflation, policy served to keep its impending financial collapse from the public generally and even from many financial

analysts. Although it is perhaps impossible to prevent such misrepresentation and deception, nevertheless, the study makes it clear that improved knowledge about the sources and uses of funds by the Penn Central would have highlighted its precarious position several years before the event. The Interstate Commerce Commission should require railroads to file detailed statements of sources and uses of funds at least on an annual basis, and perhaps on a quarterly basis. The Commission should require annual reporting of forecasted sources and uses of funds, for example, for a future one year period. Such information would aid the Commission in spotting problems before a crisis develops and before hurried poorly reasoned temporary expedients are forced by events.

The Penn Central was able to mask its techniques of delusion partially because the Interstate Commerce Commission did not assume jurisdiction over rail holding companies. Transactions between the railroad and its parent holding company and between the railroad and its subsidiaries were used to obscure data that would otherwise have been spotlighted by the railroad's reports. It is recommended that the Interstate Commerce Commission use its existing power under the Interstate Commerce Act to require reporting by all companies that are related to a railroad. Those powers seem to be ample, but if the Act's broad language (e.g. in Sections 5, 12, 20, and 20a) is not adequate to permit the Interstate Commerce Commission to eliminate the holding company ruse, then legislation should be adopted to require reporting by all companies related to a railroad in sufficient detail to protect the integrity of railroad reports.

ICC reporting requirements have been criticized as being outmoded, providing inadequate information about railroad operations and in some instances, even deleteriously influencing railroad policy (as for example, in rate cases). It is apparent from this study that improved cost information would be helpful to the Commission in evaluating applications by carriers, as in merger cases, where improved operating efficiencies are claimed as a justification for granting the application. It does not appear that the Commission gave adequate critical analysis to the claims of the Pennsylvania Railroad and the New York Central with regard to the cost savings claimed for the merger. Accordingly, the Interstate Commerce Commission should develop improved and relevant cost information and costing techniques.

There exist certain differences between ICC accounting practices for railroads and the accounting practices of other industries. Because these differences make comparisons difficult and in some cases actually distort income reporting, they deserve the ICC's attention. A change in accounting practices often meets strong opposition because it eliminates data important for historical comparisons and because any shift often creates some temporary confusion. But two matters are of particular importance.

First, the treatment by some railroads of their deferred income tax (that tax which would have been owed had the taxpayer not taken advantage of tax deferral provisions of the law) and of tax allocation agreements between related companies distorts their reporting. The railroads should at a minimum be required to clearly and prominently disclose the accounting method used in treating income taxes, the effect of tax allocation agreements, and the distinction between ICC accounting principles and generally accepted accounting principles. In addition, all railroads should be required to report income after the recognition of deferred income taxes and before recognition of income from tax allocation agreements with affiliates, on the published financial statements.

Second, railroads should be required to improve disclosure about expenditures subject to "betterment accounting", a practice used to account for improvements or replacements of track structure. Since the practice does not allow for depreciation, it serves to balloon net income in years when there are few track improvements. Because it also requires showing a substantial expense in the year a track is written off, or in the year an improvement is made, it distorts income downward in those years. This technique not only gives an illusory picture of a railroad's income, it increases the pressure on management to defer maintenance. The practice should be eliminated. At the very least adequate disclosure should be required, including disclosure of (1) the method used—

whether "betterment" or some other, (2) the total amount of nondepreciable property, (3) the depreciation that would have been charged against income had betterment accounting not been used, and (4) the amount charged as maintenance expense which would have been capitalized under standard accounting.

It has long been clear that rail maintenance expenditures are a discretionary expenditure. Thus, the level of maintenance of the rail plant is inextricably intertwined with the railroad's financial condition. The Penn Central case provides a classic illustration of a railroad with inadequate plant maintenance over a long period of time. It further presents a case of a railroad that had virtually reached the end of discretion with regard to maintenance. The Interstate Commerce Commission should establish methods for monitoring plant maintenance, including establishment of standards for rail plant condition, and of requirements for reporting maintenance expenditures. Observation of the trend of such reports would provide another measure of the railroad's condition and its ability to provide service. Rail safety standards promulgated by the Department of Transportation could be used as guidelines by the ICC and, in the interests of minimizing costly government duplication of effort, the Commission should review carefully the possibility of utilizing information about plant condition developed by the Department where helpful. (Further discussion of standards for plant condition appear at pp. 196 and 202).

Finally, the Interstate Commerce Commission should develop measures of service and require reporting relevant to such measures in the same vein as it currently requires reporting relevant to financial conditions. The measures of service, for example, might provide information on the utilization of freight cars and their availability to meet the needs of shippers, reliability in meeting schedules for delivery and pick-up of cars from shippers docks, amounts of loss and damage to cargoes, and perhaps, some assessment of the degree to which the market needs for rail service are met.

The purpose of disclosing the information noted above is threefold: First, public and user knowledge of such information may be assumed to be a helpful corrective in itself. It would enable the public to take action to protect itself from the sudden loss of rail service or the unacceptable deterioration of service while at the same time providing an objective signal for public opinion pressure to be placed upon private and public decision makers. Second, such information could be of vital assistance to government in formulation of policy and identification of specific problems. For example, in the Commission's response to proposals for rate increases, service quality is quite relevant to proper Commission action. Third, increased financial information would be very useful to present and prospective investors.

IMPROVED IDENTIFICATION OF PROBLEMS AND FORMULATION OF POLICY

The Penn Central case reveals an absence of coherent government policy response to developing problems throughout the period studied. The rail industry was significantly restructured in the 1960's largely in accordance with the demands of some private carriers. Public policy goals or interests supplied a negligible input. The major policy input into the Penn Central merger was required inclusion of the New Haven Railroad in the Penn Central system. Although the Interstate Commerce Commission considered the potential impact of the Penn Central merger on competing lines, shippers, and the communities, there was no explicit formulation and presentation of policy objectives by the Federal government relating to such matters as the development of an adequate transportation system, the impact on economic development and population location, and the relation to fuel supply required to produce electricity and other energy forms. The Antitrust section of the Justice Department interposed objections based on competitive grounds, but withdrew such objections once the New Haven inclusion was achieved. Nowhere and at no time were the fundamental problems confronting Northeast railroads addressed. To remedy such defects in policy formulation:

(1) The Secretary of Transportation should make an annual report to Congress on the condition and performance of the rail industry,

(2) The Secretary of Transportation should formulate and keep current a comprehensive schedule relating existing rail facilities to the rail transportation needs of various regions and of the nation as a whole.

(3) The Secretary of Transportation should have readily available information about changing conditions in various areas of the nation to assist him in addressing differing transport problems.

Annual report

The purpose of requiring an annual report by the Department of Transportation is to establish procedurally the responsibility of the Department of Transportation for reviewing the condition and performance of the rail industry. Absence of clear responsibility in the case of the Penn Central meant that no governmental agency felt it necessary to probe the early warning signs of the Penn Central's impending collapse and to call attention to them. The Interstate Commerce Commission currently bears some responsibility for providing this kind of information and such information is available for the Department's review. The Commission should not be relieved of responsibility and its role is discussed later.

The Secretary's annual report to Congress should not be a bare recital of financial performance by the railroad companies. Rather, the Department's report should analyze the condition of the industry from the point of view of the rail system as a national system of transportation. It should bear in mind the rail system's relation to other modes of transportation, evaluate the level of performance of the industry and its components, the condition of the plant and facilities, the level of service, and the implications of apparent trends for the continued provision of transportation service.

The Secretary's report should be based upon an analysis of the fundamental condition of the industry, of specific carriers and of specific regions of the country. Its purpose would be to alert Congress, the Administration, and the government generally to problems in their early stages so that solutions can be developed in a rational and deliberate manner rather than during the heat of crisis. The Department's report should contain proposed remedies for problems which it might identify.

Rail system report

The lack of a coherent Federal policy relevant to the problems of the Penn Central and to the transportation problems of the region which it serves is readily apparent from this study. This void is symptomatic of a more fundamental deficiency—the non-existence of an overall transportation policy. The development of a general policy would aid substantially in formulation of policy responding to more specific problems. A first step in this direction is to determine the extent of the nation's transportation assets and to compare them to transportation needs for the immediate future and then for the long run. The Secretary of Transportation may have made an affirmative beginning in this direction with the "1972 National Transportation Report." In addition to this assessment of current capability, there also should be developed an estimate of transportation needs—both for passengers and freight—and an evaluation of how well those needs are served by current facilities. In the event the Department finds that needs are not adequately served or if it projects an increase in demand for transportation, the Secretary should recommend or make suggestions for development of necessary facilities. In making the assessments and evaluation called for, the Department should take into account the interrelationship of the various modes, population trends, economic development, environmental impact, safety, costs, sociological impact, and the views of local communities and citizens.

The report should form a general, broad framework within which specific proposals could be developed and related to one another. The plan would form the context for the Secretary's annual report to Congress on the condition and performance of the rail industry. The Department would undoubtedly develop substantial expert knowledge in its preparation of the plan, and this,

indeed, would be a major benefit of the plan. To be a useful guide, the plan should be revised as needed.

The need for such a plan was illustrated at the time of the Penn Central's bankruptcy. One option available to the government was to take no action and to let the Penn Central cease operation if it did not have the resources to continue operation under the protection of the bankruptcy court. However, it was widely felt that the services provided by the Penn Central were in some way essential to the nation's economy and absolutely vital to the public welfare in the Northeast section of the country. In the absence of a plan to show the degree of dependence upon the Penn Central, the importance of the Penn Central's services had to be ascertained on an ad hoc basis. It was found that data to make such an assessment were scarce. A decision as to government assistance had to be made on the basis of sundry unrelated measures of the Penn Central's importance. An authoritative estimate of the nation's dependence on the Penn Central would have contributed importantly to the decision making process.

In developing the report, the Department of Transportation should take into account the interfaces between the various modes and should endeavor to provide for smoother intermodal coordination. For example, the use of containers and piggybacking are now accepted practice. Also a fact of life is continuing pressure to abandon rail service in rural areas. It might be very helpful in integrating container and piggyback technology and meeting abandonment issues for the Department of Transportation to examine various ways of using containers or piggyback vehicles, for example, in the movement of peak period traffic, with railroads providing the line haul and motor carriers providing collection and distribution service. The information developed might facilitate the use of motor carriers to pick up grain during the harvest while retaining part of the long haul traffic for the railroads. Such action might serve to accommodate abandonment proposals while pointing the way for continued and perhaps improved service to rural areas.

The report would also provide a context within which the Interstate Commerce Commission could make its decisions. At present the Commission acts on an ad hoc basis, confining its views narrowly to the issues and facts presented by the parties to the particular case before it. Such an approach, as can be seen in the instance of Penn Central merger and other mergers in the Northeast, has not resulted in a transportation system that adequately takes account of public needs. Thus, the Interstate Commerce Commission should utilize the report and the Department's recommendations in reviewing the various issues which come before it—e.g., rates, abandonment, motor carrier certification—and make decisions consistent with the report unless it articulates sound reasons and policies for acting otherwise.

Multidisciplinary approach

The Penn Central case demonstrates the relationship between transportation and regional problems involving factors transcending those of the transportation industry. There should exist an ongoing interagency effort which would identify problem areas and advise the interested agencies of the extent of changing relationships before they become critical. In this way the Secretary of Transportation could have available the information needed to focus on special problems at an early date. Conceivably the Secretary might assign a special task force within the Department to concentrate on meeting the challenge. For example, if this recommendation had been in effect over the past two decades, the predecessor of the Department of Transportation might have identified the need for such a task force in its annual report sometime in the late 1950's to focus upon the transportation problems of the Northeast. At that time, the Pennsylvania Railroad and the New York Central railroad were well on their downward course, the New Haven was in bankruptcy, and the passenger service problem was peaking in intensity. It would have been appropriate for the task force to have considered passenger service problems—commuter as well as intercity—along with the problems of the railroads as freight car-

riers. The fact that the rail system and the condition of the area's highways are interdependent could have been considered. Solutions could have been developed that would have permitted an appropriate response to the changing economic conditions of the area instead of by implication placing an unwarranted reliance on mergers that only papered over fundamental problems. A current instance in which such a regional task force might be helpful is in dealing with rail transport problems in the Granger area. In that region there are some financially distressed railroads and massive line abandonments are being contemplated with consequent impact upon the movement of products to and from the farm. The issue transcends merely transportation problems because also involved are issues of rural development, changing agricultural technology, and even the concentration of population and industries in urban areas.

The inter-agency group or perhaps a special White House Commission should consider the problems of the region in their broadest definitions—social, economic, environmental as well as transportation. Its goals should be to identify fundamental problems, to develop substantive data, to quantify the issues, and to formulate coherent, comprehensive reports to the responsible agency. For example, in the case of the Granger roads, the Department of Agriculture could be expected to contribute significant information and experience with regard to farm problems, the Departments of Commerce and Labor could do the same with respect to the development of non-agricultural industries, and similarly the Department of Housing and Urban Development with regard to the needs of urban areas.[1] The wealth of information that should routinely be available to the Secretary of Transportation from such sources could help avoid Penn Centrals of the future.

REVISED RELATIONSHIP BETWEEN THE GOVERNMENT AND THE PRIVATE SECTOR

Review of the Penn Central debacle makes it apparent that the nation cannot rely solely upon the private sector's ordering of events to guarantee the provision of essential rail services. With the merger of the New York Central and Pennsylvania Railroads, the resulting Penn Central, providing the great preponderance of rail transportation in the heavily populated and heavily industrial Northeast and serving as the rail system's major link to that area, became essential to the nation's welfare. Because of the merged railroad's size and importance, it appeared that its vital operations could not be allowed to cease. Thus, when it became clear that the Penn Central could not continue operation, even under the protection of the Bankruptcy Court, the government was forced to come to its rescue.

The study does not conclude that private business considerations were primarily responsible for the Penn Central's demise. But it is indisputable that exclusion of public interest considerations in combination with the crisis oriented pursuit of private goals compounded the railroad's problems. The earnings inflation policy hid the true situation from outsiders for a number of years. During that time substantial amounts of cash flowed out of the railroad in the form of dividends and investment in non-rail enterprises. Meanwhile, the rail plant deteriorated and the public was deprived of adequate service as the Penn Central slowly ground down.

The government was called upon as a financial aid source of last resort. Even at this report's writing, two years later, the extent of the government's role has not substantially altered; the course of the Penn Central's reorganization is being charted in the midst of conflicting interests of creditors, stockholders, labor, shippers, and the public's demand for improved transport service. Most of the claims are undoubtedly valid and should be vigorously asserted by the parties involved. But private advocacy cannot substitute for public responsibility of the government. The government is playing a relatively small role in

[1] On a more limited scale the Department of Transportation through the High Speed Ground Transportation Act has demonstrated with the Metroliner service between New York and Washington, D.C., and with its northeast corridor study the possibilities for making progress on difficult problems through a multidisciplinary approach.

determining the future of rail transportation insofar as it may be affected by Penn Central actions.

Although the conclusion has not been written to the Penn Central story, it is apparent that the government's role as a lender of last resort is not satisfactory. If the government and ultimately the taxpayers have the obligation of guaranteeing the continued existence of important transportation service, it should become involved in the affairs of sinking railroads at a much earlier point. The Penn Central case does not lead to the inevitable conclusion that the government must operate the rail system. Nevertheless, it does show that the pressures of private business concerns (legitimate though they may be) can force the railroad away from meeting its obligations to the public for a substantial period in advance of its obtaining public assistance. The government should take an active role in the affairs of the railroad beginning at the point where it is failing to meet its public obligations and its financial condition threatens its existence.

To suggest a more active and earlier government involvement in the affairs of the railroad is to suggest entering into relatively uncharted waters. The following remarks are offered as a basis for discussion which, hopefully, will result in an improved understanding of an appropriate relationship between the government and the private sector. The fundamental principle of the proposal is that government involvement should be made in stages and only to the degree necessary, directly related in magnitude but opposite in direction to the pressure of private interests that force the railroad away from meeting its obligations to the public. Hopefully a straightforward recognition of the competing interests will preserve the private nature of the affected carrier while ensuring that the public interest is not overlooked.

It is understandable and expectable that managers of any business will wish to be responsive to their stockholders and will make every effort to present the best possible public appearance. Sometimes this means cutting expenses to such an extent that the enterprise itself is endangered. While in a free enterprise system this generally can be accepted as the investor's risk, where essential transportation services are threatened by financial starvation the government will inevitably become involved. The real problem relates to ascertaining that point at which government involvement is optimum and to quantifying the extent of government involvement when it comes. Railroads have repeatedly been considered to be, if not public utilities, at least affected with the public interest. Like a bank which has an investment that is threatened, the Federal government should involve itself early when it appears the public's transportation is deteriorating substantially, for example, because of deferred maintenance resulting from financial difficulties.

Operational and financial auditor

The Interstate Commerce Commission should establish a set of standards to define the point at which a railroad slips below acceptable performance and financial condition, i.e., when the railroad becomes "marginal". Such standards should set specific limits for railroad operation, including service performance, railroad plant condition (or amount of deferred maintenance), operating trends (freight car utilization, labor and capital productivity, operating ratio, etc.), and financial condition (derived from an analysis of funds flow, working capital, revenue, expenses, and earnings). Such standards should be established by the Interstate Commerce Commission in a rule-making proceeding completed within a previously announced, relatively short time frame of not more than one year, and the Department of Transportation should participate in the effort to develop the standards.

Obviously, the foregoing suggestion is not free from problems. There is first the matter of defining "marginal". Judging from past ICC pronouncements this is not an insurmountable obstacle. The ICC now can provide a list of what it considers "marginal" carriers. But the determination at present is largely subjective and relies almost entirely on the Commission's observance of the carrier's financial condition without the benefit of cash flow information.

The purpose of establishing standards is to provide objective, easily recognizable guidelines eliminating subjective judgment to the extent possible. Where government action is to follow the agency finding, objective standards are essential to provide certainty and to insure fairness to the carrier. It is important therefore to develop the standards discussed above. Some of the suggestions for standards may not be easily quantified. For example, measuring the quality of service may require reliance on the number of service complaints received, and/or on some measure of on-time performance. On the other hand, the maintenance standards discussed previously at p. 191 in connection with disclosure should provide a basis for evaluating plant condition. A rule-making proceeding would be the appropriate method for addressing the numerous questions that would arise and for developing workable standards.

If a railroad dropped into marginal condition as defined by such standards, the Interstate Commerce Commission should appoint a highly skilled auditor with whatever supporting resources he deems necessary to examine thoroughly the condition of the railroad. It would seem that sufficient authority exists in the Interstate Commerce Act for the appointment of an auditor (e.g. Sections 12, 20, and 20a). The auditor's function would be to insure complete and adequate disclosure of the railroad's condition to the government and to the public. He should make a thorough and public review of the railroad's operations, financial condition, plant condition and service performance so that the government and public will not be misled by inflated earnings reports and optimistic press releases. The auditor should analyze the trends of the railroad and publicly report his view of their applications.

There is precedent for ICC identification of railroads in marginal condition. Following the collapse of the Penn Central, the Interstate Commerce Commission, in response to an inquiry by the Chairman of the Senate Subcommittee on Surface Transportation, identified railroads which it determined to be in marginal condition. Although there was concern expressed that such identification would have a deleterious impact on marginal railroads' relations to private sources of capital and their shippers, significant adverse reactions have not been noted during the two years that have since passed. Perhaps this is because such identification merely made a matter of public information what was fairly well known to those closely involved with the particular railroads.

Railroads in extremis

The Interstate Commerce Commission should establish another set of standards (using the same type of criteria above recommended for identification of marginal railroads) to identify the point at which a railroad passes from marginal condition into the critical stage. The critical stage might be that point identified by the Commission where bankruptcy is imminent unless substantial plant maintenance is deferred or where performance has fallen below the previously established minimum standard. Since the railroad has already reached marginal condition, the appointment of an auditor has provided adequate and full disclosure of the condition of the railroad and the identification of various factors acting upon it. If the unfavorable trends which brought a railroad into marginal condition are not reversed and the railroad continues to deteriorate, it would appear prudent for the Federal government to consider taking appropriate steps to insure proper performance of public obligations.

Ideally the Federal government should have available some optional courses of action at this stage. Delay is likely to produce serious deterioration of the marginal railroad's plant. Under current law rail managers in extremis will normally take every conceivable action, including the deferral of maintenance, to avoid bankruptcy. It is noted that should the ICC auditor be appointed and publicly disclose the condition of the railroad bankruptcy might be forced on the carrier sooner than is now likely. And as the Penn Central experience makes clear, an earlier bankruptcy may be of advantage to all concerned—the public and shippers as well as the investors.

However, if the capability to provide essential transportation service would not be impaired, most observers would agree that bankruptcy should be avoided.

After the ICC has determined that the critical stage has been reached for a particular railroad, the burden for action should shift to the Department of Transportation as the chief agency for the formulation of transportation policy. The ICC auditors report being public information should also, of course, be sent to the Department alerting it to the railroad's condition. In addition to the auditor's report, the Commission should also report to the Department of Transportation, the Congress, and the public, immediately upon finding that a carrier has reached the critical stage.

The Secretary should have various options available. Using the annual reports, the national rail system report, and ICC developed information, the Secretary should have the discretion to decide whether the railroad in question should be allowed to go into bankruputcy, whether it should be provided sufficient assistance to be kept out of bankruptcy or whether some action should be taken. If the Secretary decides that assistance should be provided, he should be authorized to appoint an agent who would be responsible for insuring that the public's investment is protected. The Secretary's position is much similar to that of a banker desirous of protecting an investment and he should have authority to bargain like one.

In the beginning the agent might simply take up residence at the railroad and obtain information more current and in greater detail than that obtained by the ICC auditor. The agent would become familiar with the operation of the railroad, the policies and goals of its managers, and the forces acting upon it such as shipper needs and demands, requirements and demands of financial institutions and the goals of its stockholders. The agent should have power to challenge inappropriate transactions. If the condition of the railroad continues to deteriorate further and the exercise of veto power by the agent proves to be inadequate to stabilize and improve its position (assuming that the private managers are not taking complete advantage of possibilities for improvement), the agent should seek additional authority in accordance with the Secretary's instructions.

If the Secretary selects an option which entails the provision of financial assistance, he should immediately report his actions to the Congress and the President advising on the extent of the aid and the protection employed (such as the naming of an agent).

The proposal for staged government involvement, appointment of an auditor and then of an agent when necessary, insures the public as well as the private investor of accurate and full disclosure of the condition of the railroad and, if necessary, of independent and expert management backed by the resources of the government if private management proves unsuccessful.

The intent of the above proposal is to involve the government at earlier stages than has heretofore been accomplished. With such staged, step by step involvement, it could he hoped that private sources or modest public sources of financing would be adequate. If those sources proved inadequate, or if the Secretary determined that he should not act, the railroad should go into reorganization under chapter 77 so that accounts can be settled, lost investments written off, and a new start made on a recognized railroad. If government financial assistance is required, it should follow the model of the Emergency Rail Services Act of 1970 (P.L. 91-663). If the railroad cannot be reorganized even with assistance provided under legislation such as the Emergency Rail Services Act, additional steps must be taken. The discussion of recommendations for the future of the Penn Central, below, will suggest action at the terminal stage of a railroad's crisis.

The purpose of staged governmental involvement in the affairs of the railroad prior to bankruptcy is to provide countervailing forces to the normal business pressures in order to keep service up to an adequate level and to prevent cannibalization of the rail plant under the cover of misrepresented earnings and optimistic predictions of performance. The Penn Central's case clearly illustrates the forces at work to increase dividend payments and other disinvestment in the railroad as the situation became more critical.

Legislation would be required to provide the Secretary with the kind of authority described above. The details for carrying out the authority would, of

course, be developed through the legislative process. The effort here is merely to suggest an approach in outline form.

SPECIFIC AREAS OF CONCERN

1. *Reform and Reinvigoration of the Interstate Commerce Commission.* Throughout the period leading to the Penn Central's demise the Interstate Commerce Commission was on the sidelines. When it did enter the arena, its performance was disappointing.

The principal cause of disappointment is the Commission's oft stated view of its role: a passive arbiter finding the balance point between conflicting demands principally of private parties (calling balls and strikes as one court put it). It seems that the public would be better served if the Commission adopted an active, vigorous attitude. Preceding recommendations have proposed that the Commission acquire additional historical information, obtain forecasts so that it may evaluate policy rather than accomplished fact and formulate standards by which to measure the performance of railroads. The recommendations to follow will expand upon this theme. The Commission should move to analyze issues and problems before they are brought to the Commission in the form of cases, so as to have a framework and some guidelines to provide assistance in decision making.

Furthermore, the Commission should undertake independent investigations and analyses. Currently the Commission, even in its rule-making proceedings, relies almost entirely upon information and analysis presented to it by the parties to the cases. This practice introduces an inherent bias in favor of the interests able to be represented because the public is rarely represented in such cases. As has been suggested a number of times in the past, the Commission should make its Bureau of Enforcement or Bureau of Accounts, or another, perhaps newly created body, such as a consumer counsel, a party to cases with a mandate to independently explore and present information and issues bearing upon the public interest.

Frequently noticed during review of the Penn Central's collapse was the ponderous tempo of the Commission's proceedings. The merger decision required five years before the Commission; division's cases drag on for a dozen years; freight cases involving innovative proposals by individual roads consume years (whereas massive across the board increases too often receive inadequate attention). In fairness, it must be recognized that such delay is not entirely the Commission's fault. Often cases decided by the Commission become involved in lengthy court battles. But the Commission's stance as a passive arbiter acting in response to the initiative of parties to cases permits the parties to drag proceedings out in order to benefit their particular interests. Wherever the fault may be discovered, however, delay at the Commission has had serious adverse effects upon the rail industry.

The Commission should make every effort to expedite its procedures and come to decisions much more quickly than it presently does. If necessary, the Interstate Commerce Act should be amended to establish statutory deadlines for completion of cases. If the Commission will adopt an active role, utilizing its own resources to dig out information and to analyze it, many cases should proceed to a decision much more quickly.

It may be that the Commission cannot escape its passive role. If that is the case, it might be appropriate to assign investigatory functions to other bodies. Further, it might be appropriate to assign to another body the duty of insuring the presentation of the public interest in regulatory cases. Finally, if the Commission cannot utilize the broad authority granted under the Interstate Commerce Act, consideration should be given to substantial revision of the Act to establish even more specific guidelines for Commission action.

2. *Diversification.* The lessons of the Penn Central with regard to diversification are ambiguous. On the one hand the 1960's diversification programs of the Penn Central and its predecessors provide examples of improvident and unsuccessful ventures which proved injurious to the railroad. On the other hand,

the Penn Central's experience does not disprove the basic theory of diversification. Thus, the study cannot conclude that railroads should be absolutely prohibited from engaging in diversification activities. The Penn Central does indicate, however, that rail diversification into non-transportation areas must be regarded suspiciously.

The Interstate Commerce Commission has proposed legislation which would permit the Commission to review, after-the-fact, investments outside the transportation industry and would authorize it to require the undoing of such transactions if necessary. The Commission's request bill in essence states that diversification is an area to be watched, but says nothing about which diversified investments are appropriate or inappropriate. It may be perceived that the foundation for the Commission's legislation is lack of knowledge of the impact of diversification upon the rail industry.

An alternative to the ICC's bill would be to require prior notification of the ICC by the carrier. This would afford an opportunity for prior review. A relatively short period, not to exceed thirty days, could be allotted for the review. During this period the Commission could question the carrier about the proposal and if dissatisfied could take appropriate steps to stop the transaction.

Concerns of the Commission's staff about the effects of diversification were brought to the Committee's attention more than two years ago but more information should be developed about the implications of diversification. The ICC has not undertaken any formal investigation and since no such activity by the Commission appears to be forthcoming, the Congress should open its own inquiry. The interest of members of the Committee in this subject has been expressed to the Commission in public hearings and other ways for a substantial period of time. The Committee should through hearings examine the diversification question fully in the 93rd Congress and at that time consider all possible legislative and non-legislative alternatives.

3. *Rates.* The matter of rate regulation was before the Committee in the form of several specific bills (most notably S. 2362 and S. 2842) during the last Congress (the 92d Congress). The bill introduced at the request of the Department of Transportation (S. 2842) would have moved in the direction of decreasing the degree of rate regulation. The other bill (S. 2362) would have moved in the opposite direction. The Penn Central case provides no clear indication as to the preferability of one policy over the other. Indeed, the investigation of the Penn Central suggests much the same conclusion as that reached from analysis of testimony presented to the Committee on the two bills: adjustments in the regulatory framework involve questions that are extremely complex because any significant modification will affect not only relationships between carriers but also a myriad of relationships between shippers and further between different regions of the country. Facts and detailed analyses regarding different regulatory policies are scarce. Too much reliance has been placed upon simplified and abstract economic theory as justification for lessened regulation while maintenance of the status quo has been the grounds for opposition to such a policy.

The Interstate Commerce Commission nearly two years ago instituted Ex-Parte 270 and Ex-Parte 271 to provide information on the rail rate structure and the investment base of the rail industry. During the two years the Commission has not moved noticeably closer to deriving conclusions from its study. In addition, the Commission while announcing its intent to appoint public counsel has not done so at this writing. The need for the Commission to complete a thorough study within a reasonable time frame cannot be over-emphasized. The results of Ex-Parte 270 and Ex-Parte 271 could provide much of the information needed for analysis of many important issues.

In the meanwhile, a few general recommendations might be made. To begin with, the Interstate Commerce Commission should consider the broad ramifications of its rate cases. Currently it appears to restrict its vision narrowly to balancing the impact upon carrier revenue and the impact on other carriers against

shippers' interests in keeping rates as low as possible. But, as noted above, rail rates have broad impact upon a great number of matters: the Commission should take into account such factors as environmental impact (one example of which might be the diversion of additional traffic to the highways with consequent air pollution and crowding of the highways), fair rates for recycled materials, safety impact (the National Transportation Safety Board estimated that 2,014 lives and 26,537 injuries would be avoided per year if the Department of Transportation's deregulation bill were enacted because of the resulting diversion of some 239.7 billion ton-miles of traffic from the highways to the railroads),[2] competition between railroads and between rail and other modes, regional economic and population development and growth, and industry location.

Another recommendation is that the Interstate Commerce Commission encourage reasonable innovation in rates and rate structure. As a result of the Commission's passive stance, a determined opponent to rate change may be able to delay or even kill an innovative proposal. The Commission could decide faster with the help of independently derived information, the merits of such proposals rather than relying on a prolonged adversary process to produce the decision.

Railroads are permitted to fix prices among themselves and do so through the rate bureau mechanism. The Commission, which pursuant to Section 5a of the Interstate Commerce Act enjoys total authority over the operations of Rate Bureaus, should exercise its power to obtain comprehensive information about the activities of Rate Bureaus. The Commission should analyze the data from such a study and ascertain the effect of Rate Bureaus upon the nation's transportation system and economy. Further, the Commission should interject itself into the activities of Rate Bureaus. It should have a representative in attendance during all stages of consideration of rates between carriers in significant cases. Its representative should not only observe the proceedings but should also be obligated to submit reports with respect to actions taken by the Bureau as they are likely to affect the public interest. A partial precedent for this is the practice of the Civil Aeronautics Board which provides for CAB representation in many rate and other discussions between airlines.

The study of the Penn Central's operations over a number of years makes it clear that rates are affected not only by the carriers but also by the pressures of major shippers on such carriers. The effect of especially large shippers in influencing rates to the detriment of the railroads as well as other shippers has been largely overlooked. Information as to their role is as skimpy as other information about rates. Thus, the Commission should require information on the traffic share of the largest 50 shippers and the specific disclosure of all special arrangements made by carriers for such shippers. The purpose of this information would be to provide a base for understanding the role that shippers play in rate setting and in service.

4. *Dividends.* The Penn Central paid extraordinarily high dividends resulting in a substantial flow of capital out of the company during a period of severely deteriorating financial and operating conditions. Those patently unjustified cash losses contributed to the necessity for the Federal government to come to the rescue with financial aid. Analysis of the industry generally reveals high and perhaps excessive dividends payments to be a general pattern. If the industry and its component members were financially healthy and providing adequate service, the size of dividend flows would be of no consequence. However, many segments of the industry are not in that enviable state. The Interstate Commerce Commission should give particular attention to the timing and amount of dividend payments by carriers in its investigations. In Ex-Parte 270 and 271 the Commission is developing information with regard to dividends. The Commission must consider the entire question of intercompany flow of funds, including dividend payments, in terms of the impact on the railroad's ability to provide transportation service.

5. *Abandonment.* The study of the course of the Penn Central's collapse provides no special insight into the issue of abandonment. Abandonment is one

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[2] National Transportation Safety Board recommendation 1–72–1 issued on May 26, 1972.

way in which railroads may attempt to respond to changing conditions. It is noted that the Penn Central merger was not predicated on substantial abandonment. Perhaps this is further reflection upon the failure of the merger architects to come to a conclusion as to goals for the merged railroad.

Review of the Penn Central case does, however, reaffirm evidence of the great importance of this railroad to the area it serves. This vital importance means that abandonment should not be decided simply upon the basis of a particular line's effect on the revenues and expenses of the carrier in question. Rather, the broader and complex issues of impact on the region's economy, environment, and social structure must be examined. Further, the interest of the localities involved in abandonment should be taken into account in deciding the issue. Some form of financial investment by the Federal government in otherwise uneconomic lines should be considered if the local region served by such line is willing to share in the cost. The Congress took action of interest regarding abandonments in the 92nd Congress.[3]

6. *Divisions.* Division of revenues between railroads who join in a movement presents a knotty problem intrinsic to the structure of the industry. Although railroad properties combine to form a system to move goods from one point to another, each railroad is an independent enterprise which attempts to realize as much as possible out of through rates. Each has, of course, substantial interest in obtaining as large a portion of the joint revenues as possible. Therefore, cases to establish divisions are bitterly fought between the railroads, generally between railroads grouped into territorial allies. Because of the potential influence of divisions on the economic health of a region representatives of government within affected regions also become directly engaged. The outcome of these disputes is of such importance that equitable resolution should be of great concern to government.

7. *Merger Policy.* The Interstate Commerce Commission must take a more decisive role in merger cases. An important first step would be to formulate criteria in a rulemaking procedure for use in deciding merger cases. An important element of such criteria should be information bearing on the regional impact of mergers. The Penn Central, C&O, B&O, and Norfolk and Western merger cases in the Northeast illustrate conclusively the folly of considering mergers in isolation from their impact on a region's transportation. Here is another area where the Commission should rigorously adhere to a systems point of view. It must acknowledge that merger between two roads powerfully effects the relationships among and with the other roads in the region, not to mention the impact that competitive shifts may have on users of the transportation.

In formulating merger criteria the Commission should reject the concept that mergers are necessarily a remedy for the ills of weak or dying railroads. The Penn Central collapse illustrates the utter fallacy of that idea.

Merger criteria must stress as a primary objective the service to be provided by the railroads. In this, the Commission should require continuation of ade-

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[3] See P.L. 92–591, S. 1729 as it passed the Senate, and S. 2362 as reported by the Senate Commerce Committee in the 92nd Congress.

quate service during the period of implementation of the mergers so that there is not a service hiatus as there was during the Penn Central consolidation.

The Commission should give very careful attention to intermodal implications of mergers in recognition that mergers affect the structure of the transportation system and that the system is composed of various modes of carriers.

Finally, the Commission's standards should stress development of competition between carriers in the same mode and between carriers of different modes so that total reliance upon one carrier as an indispensible element of a transportation system is minimized.

A temporary moratorium on mergers should be declared until the Commission promulgates standards and criteria consistent with section 5(2) of the Interstate Commerce Act upon which it will base its merger decisions. As with other recommendations, the Commission should be required to complete such proceeding within a fixed but reasonable deadline.

8. *Recognition of User's Interest At DOT.* The Department of Transportation should explicitly provide for institutional representation of user's views within the Department structure. At present, the Department, by its institutional structure, is largely oriented to the needs of the various carrier modes. Thus, at the time of Penn Central bankruptcy, the Executive Branch came forward with a proposal for financial assistance to save the Penn Central from bankruptcy. That proposal contained no requirements to insure that the Penn Central provide adequate service to shippers. The concentration on the carriers' problems to the exclusion of shippers' problems was apparent.

9. *Service.* Implicit in the recommendations made throughout the report is a focus on service as the primary criteria for judging the adequacy of the nation's transportation system. Too frequently, it seems, current criteria, to the extent any criteria exist, focus upon a carrier's financial health. The assumption is that a strong carrier will provide adequate service. As the Penn Central case makes so clear, concentration on financial issues can involve management in so many problems of such overwhelming difficulty that implications for service can be completely neglected. But in an area like the Penn Central's it does not follow that eliminating financial stress to the carrier will mean better service. The Interstate Commerce Commission should use its authority, especially in rate cases, to insure the provision of service at adequate levels. The Department of Transportation, as mentioned above, should look to the service provided by carriers, not just to their financial and operating problems. There must be a balancing of the interests.

10. *Plant Maintenance.* To reiterate a point made several times previously, the Interstate Commerce Commission should establish standards for plant maintenance. Such standards should not intentionally duplicate standards for safety established by the Department of Transportation, but could rely on such safety standards for guidance. Their focus should be on those manifestations of poor maintenance, such as "slow orders" which have a direct bearing on service.

The Penn Central case illustrates the dilemma of a railroad with declining income: it can defer maintenance on its plant for a substantial period of time but at some point must provide the necessary maintenance. However, if substantial deterioration has occurred, maintenance alone may no longer be adequate to improve the road's fortunes. Thus, investment in plant may not produce an acceptable return. In addition, by the time the carrier reaches such a state, its resources are likely to be at such a point of exhaustion that it cannot bear the burden of substantial restructuring of its plant or the introduction of innovative operations necessary to respond to changing market demands.

It may well be that the Penn Central and other railroads will be unable with private ownership and through private financing to adapt their plants to the demands of their regions and shippers. Consideration should be given to alternative ways of government provision for such essential parts of the plant

as roadbed and communication systems. This approach could place railroads on a par with other modes of transportation. It may be the only way to deal with problems of the Penn Central and others. User charges should be provided so that the government's full cost of investment is eventually recouped.

11. *Freight Cars.* Like divisions cases, ownership of freight cars is a difficult issue created by the structure of the rail industry. Review of the Penn Central's files shows recognition by a number of its officers that the Penn Central has been responsible in substantial measure for freight car shortages throughout the country.

Reflecting upon the catastrophic performance of freight car management during the consolidation process gives increasing support to the view that freight car shortage problems are as much a problem of utilization of freight cars as of inadequate freight car numbers. Furthermore, the impact of the performance of one railroad upon the supply and utilization of freight cars by other railroads is apparent. The rail industry's use and acquisition of freight cars should be considered from a systems point of view. A mechanism should be developed to assure supply of freight cars adequate to meet the needs of the system as well as to meet the needs of individual carriers. Remembering that the Penn Central put freight car acquisition and use at a rather low priority as its financial difficulties mounted, it bears recognition that individual roads cannot in pursuit of their own goals be relied upon to supply and manage freight cars in ways that meet the total systems needs.

A freight car management system would help improve the functioning of the rail system.

12. *Government Assistance.* The failure of private management to prevent the Penn Central's collapse is sufficient grounds for recommending that governmental assistance should not take the simple form of financing the activities of individual railroads. Sharing the Federal revenues with the managers of railroads is likely to lead simply to increased disbursement of assets to rail owners through higher dividends and reduction of private capital.

Except in rare cases with adequate safeguards, governmental assistance should be directed toward specific objectives and particularly those projects or objectives consistent with a systems approach such as development of a national freight car information system, and improvement of major rights-of-way, perhaps through acquisition by the government.

In view of the need for modernization and restructuring of the rail plant, governmental assistance should be directed to the railroads' capital structure rather than toward subsidization of operating costs. The exception might be where the Secretary of Transportation decides to provide assistance and install an agent for railroads in extremis as discussed earlier. The government should have adequate controls to insure that the assistance provided by it is properly directed toward achieving the desired objective.

Of course, government involvement should not result in a worsening of the employees' positions. Thus, government aid will need to be accompanied by standard legislative provisions to assure protection of the employees' interests.

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Recommendations for the Future of the Penn Central

A major reason for review of the Penn Central debacle was to determine what could be done about the Penn Central. The urgency for creating an adequate rail system in the Penn Central's territory should not be lost in discussion of industrywide solutions.

The recommendations made above for staged governmental involvement in the affairs of declining railroads are of applicability to the industry generally, but not to the Penn Central. The Penn Central has already cascaded through the stages of marginal, critical, and now bankruptcy. It appears unlikely that it can be reorganized under existing bankruptcy laws within the foreseeable future.

Contrary to assertions made in the days immediately surrounding the Penn Central's bankruptcy, the Penn Central's problem was not one of temporary cash shortage. Of primary importance was the need for vastly improved service combined with innovative marketing and pricing techniques. Improved service requires as a prerequisite better maintenance and more capital investment than the Penn Central is capable of making at the present time or for the foreseeable future. The trustees have managed to do better than many had expected, but the Penn Central, without paying taxes and without satisfying all its debts, is still losing a colossal sum of money every year. It is treading water, but that will not be enough if it is to meet the needs for rail service in the Northeast. It is doubtful that creditors or other prebankruptcy investors will stand silent if any additional debt is placed before their security.

It is clear that the Penn Central cannot be considered in isolation from other railroads in the Northeast. It is probable that all Northeast rail service must be considered together to reach a sound policy conclusion about the future. The constraints on restructuring of the Penn Central imposed by creditors and shareholders and the likely need for additional funds to accomplish such a restructuring make continued government involvement almost inevitable.

If the dilemma in the Northeast is to be resolved properly, government must analyze the area, decide what is necessary rail service and then must decide how to take care of local uneconomic lines. This effort might be broken down functionally, with separate entities looking at coal, commuter service and so forth. There should be sufficient flexibility to deal with the various problems and experiment with answers. There could be many different approaches, but one that is quite interesting and deserves more exploration calls for the creation of a Northeast Transportation Authority with authorization for it or another government controlled entity to operate essential rail service in the Northeast if, as now appears to be the case, the private sector is unable to restore the viability of rail transportation in the Northeast. This approach has two fundamental strengths: it permits the operation and restructuring of bankrupt railroads to be separated and insulated from the often prolonged disputes between creditors and stockholders over the corpse of the bankrupt railroad and it permits the Authority to concentrate its efforts on the improvement of service and satisfaction of public needs. An integral part of the recommendations is that the Authority be directed to experiment with means of improving rail operations and service. It would obviously do little good simply to transfer ownership and control from the private to the public sector without providing for efforts to answer the fundamental problems of rail transportation in the region.

The Authority's jurisdiction should include the region served by the Penn Central and those parts of New England not served by the Penn Central. Such an Authority should be fashioned so as to take cognizance of Federal, State, and local transportation concerns. Its mandate should be to propose a rational structure of railroads for the region consistent with a national rail systems approach.

It should sponsor a review of the Northeastern rail network by an independent body or by the Authority itself. Such review should develop a schedule or plan setting forth the essential rail network in the Northeast. In determining what is essential the Authority should be guided by the same criteria outlined previously for the Department of Transportation's national report (i.e., environmental, sociological, economic, and demographic factors). Whether or not a particular rail line is self-sustaining or produces a profit should not be the sole determining factor.

Once the essential service is identified, a specific plan should be prepared that would define the actions to be taken by the Authority and by the concerned levels of government or others with respect to future operations.

If the Authority finds that the existing framework will not yield the necessary result, the Authority, or perhaps a quasi-public corporation, could be authorized to take over the operations of all bankrupt railroads in the Northeast. The Corporation could acquire the systems through the issuance of bonds or debentures to the trustees of the bankrupt roads. The trustees in turn would issue the debentures to the various claimants in accordance with an appropriate order by the bankruptcy court. The debentures should equal the liquidation value of the railroad involved. The debentures would be satisfied from the rail operations, hopefully keeping the cost to the Federal government at a minimum. It might prove necessary for the Federal government to guarantee the debentures in order to make them more marketable.

The Authority (or Corporation) could at the same time place the stock, which it acquires in exchange for the bonds, in escrow until such time as it is determined by the Corporation, the Department of Transportation, and the Interstate Commerce Commission that the railroad is viable or that portions are sufficiently self-sustaining to release the stock from escrow for public sale. This would insure an eventual return to private ownership provided viability is restored.

The Corporation (or Authority) should have power to enter into arrangements with local or State governments for the maintenance of service over nonessential rail lines. It should have the power to sell off portions of the system to interested public or private entities so long as such action is consistent with the public interest.

There exist a multitude of issues which would attend the proposal for a Northeast authority and a subsequent operating entity. These include questions about representation of the various political subdivisions on the Authority, weighing the impact on competing modes, regulatory jurisdiction, the extent of Federal assistance for the Authority, and the shape of labor protection. The purpose here is to suggest in general terms a method for solving serious transportation problems in the Northeast. The difficulties, like those mentioned above, which will confront any proposal, can best be dealt with by the legislative process.

Many theories have been advanced for restoring the viability of railroads in the Northeast. On the basis of information now available it cannot be said with certainty which theories or proposals might prove to be most productive of the desired result. It is not yet known the extent to which innovative marketing and pricing techniques or new terminal efficiencies can be meaningful in the context of the Northeast. The inextricable government involvement with the Northeastern railroads provides a unique opportunity for testing various theories. Whether or not an Authority is established to take over and operate the bankrupt Northeastern railroads, the Department of Transportation working with the trustees should take advantage of the opportunity to test various concepts on a demonstration project basis. What follows is a discussion of some of the experiments or demonstration projects that might prove helpful in solving problems in the Northeast and elsewhere. For convenience the following discussion of experimental projects refers to the Authority as the entity in control of operations:

Pricing and Marketing.—The Authority should at an early date determine whether railroads can adapt to the changing demands of the economy in the Northeast. It should identify major types of traffic whose rail carriage might be expanded. It should then test techniques of marketing, service, and pricing

aimed at obtaining such traffic. In conducting such a test, the Authority should establish criteria by which the benefits of such carriage, and the increase in such traffic attributable to the tested techniques, could be measured. It should set aside a separate segment or region of its operation for conducting the test so that its results in the control segment could be compared with other operations where current methodology is used.

The Authority should also test under controlled conditions the effects of innovative pricing policies on the carriage of existing traffic.

It might prove useful for the Authority to develop a model or a system of techniques for analyses (perhaps using computer technology, if it seems appropriate). The purpose of such a model would be to key in operating characteristics, traffic patterns, capacities and so forth and to test the impact of alternative pricing, operating practices, or abandonments. Such models could greatly reduce the uncertainties which now attach to adjustments in prices, operations, and abandonments. It could be of assistance to carriers and public agencies as well.

Operations.—It appears that rail operations offer substantial opportunities for improvement in productivity through technological and management advances. For example, the Authority should test the practicality of new ideas for terminal reorganization and train operation. It should test methods of improving equipment utilization, giving particular emphasis to use of computerized car location and control systems. In this regard, consolidation of a number of railroads in the Northeast under the Authority would offer an opportunity to obtain the benefits of computerized interrailroad information systems—an opportunity which is now largely denied by the proprietory interests of individual railroads in preventing information about the movement of rail cars on one railroad from being made available to other railroads.

In control regions the Authority should test the practicality of orienting their operations more toward customer service than toward the convenience of railroad operations.

The Authority should give particular attention to tests bearing on the issue of whether common carrier service can satisfy the needs of shippers. In the last decade railroads have tended to acquire equipment limited in use to the needs of specific traffic. They have preferred special purpose cars over general purpose cars, at least in part, because special purpose cars permit easy calculation of related revenues and expenses. The Authority should develop information as to whether this is an inevitable trend or one produced by current inability to use general purpose cars effectively or to calculate their profitability. The Authority should look into the impact of assigned service cars and assigned pools of cars.

Service.—All areas recommended for testing by the Authority should measure the impact on service. However, there are specific areas of concern toward which the Authority should direct its attention. It should test whether less-than-carload shipments and other small shipments can be expeditiously and profitably handled through use of modern terminals, machinery and computer technology. The Authority should strive to improve its service reliability, timeliness, and speed so that it can obtain increased traffic in manufactured goods. The Authority should test increased emphasis on trailer and container on flatcar traffic. (In this regard it might be noted that the Penn Central trustees have given such traffic increased attention.) The Authority should test methods of reducing loss and damage in movement and of speeding resolution of loss and damage claims.

The rail industry has apparently decided that traffic to small or out-of-the-way places is unprofitable. It has responded by mounting a major effort to abandon lines to such locations. The Authority should examine ways of providing service to such locations more effectively in lieu of abandoning service. In controlled areas it should thoroughly test the revenue and expense impact of appropriately selected branch lines on the total rail system. The Authority should examine the impact from the broadest, systems point of view, taking into account operating considerations such as the importance of linkages between various lines as well as the amount of traffic solely related to branch line candidates for abandonment.

Managerial Techniques.—In reaction to the apparent lack of coherent corporate goals and diffuse direction of Penn Central operations, the Authority should explicitly identify the major problems to be surmounted in order to operate a successful rail transportation system in the Northeast. The Authority should also establish long and short range goals for operations and disseminate such goals through its organization so that the activities of all of its employees can be consistent with them. In establishing such goals the Authority should be directed to give paramount importance to serving the transportation needs of the public, but it should at the same time strive to make its operations profitable overall.

The Authority should test alternative management structures for the railroads under its control. For example, it might in one segment of the area under its jurisdiction experiment with local decision-making to the greatest practicable extent. It might also examine alternative functional organizations. The ultimate criteria of such experimentation should be improved service and satisfaction of public needs. The Authority should also be able to determine the relative costs of different types of organization and their efficacy in bringing into the decision making process all relevant data and factors for consideration. It should evaluate the alternatives in terms of mutual support by interdependent functions produced by the different organizational patterns.

It is in order at this point to mention a word about the rail labor situation. Responsibility for efficient use of labor lies with those responsible for operating the railroad. Despite the frequent charge that railroads are hampered by restrictive labor conditions, the study did not produce evidence substantiating recommendations relating to specific practices. Rather, it appears that the railroad labor "problem" is fundamentally the same issue as in other industries—a matter of balancing the interests of the employees with the desires of management. Its resolution must be accomplished insofar as possible by the parties involved.

Part II

The American Railroads: Posture, Problems, Prospects

FOREWORD

This report surveys developments in the Class I railroad industry. It has been prepared for the Senate Committee on Commerce by Richard J. Barber, serving as a consultant pursuant to section 202(i) of the Legislative Reorganization Act. It focuses on the 1960–1970 period and seeks to illuminate longer term trends in rail transportation. The objective has been to provide information that would permit more specific matters, such as the collapse of the Penn Central, to be placed in a larger perspective. In accordance with the agreed statement of work the report emphasizes the analysis of basic economic and financial conditions in the industry rather than the formulation or assessment of policy recommendations.

Any conclusions or recommendations made in this staff report represent the views of the staff. The report has neither been approved, disapproved, nor considered by the Senate Committee on Commerce.

THE AMERICAN RAILROADS: POSTURE, PROBLEMS, AND PROSPECTS

Highlights and Conclusions

(1) One of the major ingredients in the railroad "problem" is the oversimplification with which it is characterised, explained, and proposed to be solved. All too common is gross superficiality in describing the problem and in identifying its causes. Various groups have their own devils and pet cures. In fact, however, the problem is multi-faceted. It varies in character and severity from region to region and from railroad to railroad. Many factors and participants have contributed to its aggravation: an economy that is changing in composition and regionalization, public policy, shippers, rail labor, and railroad management itself. The search for appropriate policy responses must take into account all these elements or else there is grave risk that in specifying a supposed solution, nothing will be accomplished and conceivably the problem could even be made worse.

(2) There are great differences among the various railroads that make up the Class I lines. Some are financially sound, others are not. For some traffic is growing steadily, for others the traffic outlook is bleak. In operating conditions, quality and adequacy of plant, density of service, mix of traffic, exposure to intermodal or intramodal competition, as well as many other respects, the railroads vary considerably. From the standpoint of possible changes in government policy (including the character of regulation, financial assistance, etc.) these differences mean that approaches helpful to one railroad or region would be of little help, and perhaps even detrimental, to other railroads and regions. It must constantly be kept in mind, however, that the railroads do make up a system, with nearly half of all freight revenue in 1969 derived from traffic hauled between two or more rail regions. Needed is a highly flexible set of policy responses, rooted in a complete understanding of all facets of the interconnected railroad problem.

(3) In assessing the recent performance of Class I railroads the Penn Central seriously distorts the results. This is true in virtually every key variable. For example, in 1969 the railroads' net ordinary income fell by $55.2 million but the Penn Central's ordinary income alone fell by $80.0 million. All the other Class I roads as a group thus actually reported an increase in income. Between 1969 and 1970 the Class I roads' ordinary income fell by $288 million, but $243 million (84 per cent) of this was attributable to the Penn Central. Despite its recent decline, the Penn Central in 1970 still accounted for over ten per cent of total railroad traffic and almost 13 per cent of total rail freight revenue. The result of these traffic and revenue shares is such that in 1970 the average revenue per ton-mile for all Class I railroads was 1.43 cents. But if the Penn Central is excluded, this yield index declines to 1.40 cents. These are striking illustrations of the misleading impressions one can gain or convey by considering all railroads as a group.

RAIL TRAFFIC AND THE ECONOMY

(4) The railroads are a highly cyclical industry, powerfully affected by the ups and downs of the economy. This calls for considerable caution in generalizing about their basic position from short-term developments and is especially true at present because of the nation's protracted economic recession. From 1967 through 1970 the economy (in real terms) grew at an average annual rate of only about 2.7 per cent, less than half the annual rate in the preceding five years. This alone would have had a chilling impact on the railroads; when coupled with increased rates put into effect by the railroads beginning in 1967, the slack economy has seriously depressed rail earnings. With far more rapid rates of growth forecast for the near future, railroad earnings again can be expected to rise substantially.

(5) The rate of growth, composition, and geographic makeup of the U.S. economy plays a key role in shaping the transportation environment and in explaining the problems of the railroads. Although the volume of total intercity freight transportation has been expanding at about the same rate as the Gross National Product (real GNP increased 48 per cent between 1960 and 1970, total ton-miles increased 46 per cent), the mix of the economy has changed in a way that has been clearly disadvantageous from the standpoint of the railroads. The service-finance and real estate-government areas are now growing most rapidly, while the agriculture/forestry/mining sectors are shrinking in relative importance. In 1929 the agricultural/forestry/mining sectors accounted for more than 12 per cent of the nation's gross output. By the late 1960's their combined share had fallen by half. This is a development of great transportation consequence. Many of the most rapidly growing sectors generate little freight transportation demand compared with those whose economic consequence is diminishing. Output of agricultural, forestry, and most mining products (including coal) has and will continue to lag well behind the growth of the economy. As long as the railroads are dependent on these sectors for a large part of their traffic, their growth inevitably will be hampered.

(6) Although comparable commodity statistics for earlier years are unavailable, since 1964 there has been no dramatic change in the makeup of rail traffic. The industry still predominantly hauls bulk items with relatively low yields. For example, almost half of all originated rail tonnage is composed of three classifications: coal, stone and minerals, and metallic ores. Yet these commodities contribute less than 20 per cent of total rail revenue. Even though there has been an increase in "piggyback" movements, existing data show that the rail share of manufactured commodities has slipped slightly.

(7) Not only have railroads been adversely affected by the changing mix of the economy, but particular lines have been hurt by shifts in the location of economic activity, by technological innovation, and by input substitutions. This has been particularly noticeable in the case of the railroads serving the northeast. In 1929 New England, the East North Central states, and the Middle Atlantic states together accounted for more than 72 per cent of total value added by manufacturing throughout the United States. By 1965 their combined portion had fallen to less than 60 per cent, with the Southern and Far Western states sharply increasing their share. There have been similar shifts in nonmanufacturing activity. Coal mine production has tended to shift south, with Pennsylvania becoming less important and Kentucky assuming considerably greater significance as a generator of traffic. Railroads in the Northeast have been severely affected by these trends. In addition, the substitution of less transport-intensive inputs and the development of production techniques that call for less transportation (such as the generation of electricity closer to coal mines and its transmission by long-lines) also has reduced transport demand, with a particularly noticeable impact on the railroads.

(8) Manufacturing is the most important source of transport demand for the rail and truck modes of transportation. In the 1960's however, the railroads failed to gain manufacturing traffic from the trucks—for long-hauls as well as short. (Indeed, out of 24 commodity groupings of manufactured products, the railroads have lost ground in 16 categories.) This loss of high-valued manufactured goods traffic has been one of the principal underlying explanations of railroad problems. Only by regaining and participating more substantially in this traffic can the railroads expect to grow and prosper.

(9) In the 1950's and 1960's the railroads' share of intercity freight transportation fell by more than a fifth, declining from 56 per cent in 1950 to 40 per cent in 1970. More than two-thirds of this came in the 1950's, but there was continued attrition during the 1960's—with the sharpest year-to-year decline coming between 1966 and 1967 (when, as will be noted below, rail rates were steeply increased). Despite a 35 per cent increase in ton-miles, the railroad industry saw its share of the transportation market (as measured in ton-miles) slip from 44 to less than 41 per cent between 1960 and 1970. Although the stagnating traffic situation since 1967 is responsible for some of this slippage, it should be emphasized that even in the relatively better years (1960–66), the decline in rail market share was not arrested.

FINANCIAL CONDITION

(10) From a financial standpoint, no single index adequately measures the health of the railroads. From 1966 to 1970 railroad earnings declined and net working capital fell, but despite these developments railroad cash flow (ordinary net income plus depreciation and retirements)—perhaps the best single measure of financial viability—still exceeded $1 billion in 1970 (about the same as it was in 1960). Although down from 1966, this cash flow position hardly suggests that the railroads as a whole are in dire financial straits. Indeed the ability of the railroads to generate this much cash in a recession year and in the face of higher freight rates must be regarded as a major accomplishment.

(11) A review of the 1960's shows that a distinct break came in 1967. In the earlier part of the decade rail traffic grew rapidly. The Class I railroad operating ratio fell, net railway operating revenue climbed by 30 per cent (up nearly $600 million from 1960 to 1966), ordinary income more than doubled (reaching more than $900 million in 1966), and by 1966 cash flow amounted to almost $1.4 billion. The explanations for this period of prosperity included a rapidly growing economy, increasing capital and labor productivity, and falling rates. Average revenue per ton-mile declined by over ten per cent from 1960 to 1966 but originated tonnage rose by 17 per cent. Beginning in 1967 the railroads as a group went into a serious slump. Railroad freight traffic declined absolutely in 1967 and between 1967 and 1970 rail originated tonnage grew by less than six per cent. Although railway operating revenue held up well, other expense items (notably for rents and fixed charges, both related to increasing capital investment) rose sharply. As a consequence Class I rail operating income dropped from over $900 million in 1966 to $227 million in 1970. Cash flow also declined, although not as steeply (it still exceeded $1 billion in 1970, although down from $1.4 billion in 1966). From the traffic and operational standpoints, several factors contributed materially to the 1966–1970 downturn. The economy slowed and almost simultaneously the railroads hiked their rates. In just four years, to 1970, general rate increases resulted in a more than ten per cent increase in yield per ton-mile. Combined with a slowing economic growth rate, rail freight traffic slackened noticeably and the rail share of total intercity freight transportation fell by three percent.

(12) During the 1960's the net operating revenue of the Class I railroads (total operating revenues less total operating expenses) remained remarkably stable. The operating ratio fluctuated in a narrow band, falling from 79.52 in 1960 to 76.19 in 1966 and then climbing back to 80.56 in 1970. Nonetheless net railway operating income and ordinary income fell sharply, with the former $100 million less in 1970 than in 1960 and the latter almost $200 million less. The explanations for this marked disparity between net operating revenue, on the one hand, and net railway operating income and ordinary income, on the other, are to be found principally in the behavior of three items: payments for rented equipment, fixed charges, and "other income." The former two swelled immensely during the decade and swamped reported gains of $136 million (1960 to 1970) in "other income." Payments for rented equipment increased from $321 million in 1960 to $736 million in 1970—up by more than the increase in net operating revenue. Fixed charges also rose steeply, soaring from $373 million in 1960 to $589 million in 1970, reflecting increased amounts of debt outstanding and rising interest rates.

(13) Gross capital expenditures by the Class I railroads increased substantially during the 1960's, peaking at nearly $2 billion in 1966 and falling to $1.4 billion in 1970 (this compares with $919 million in 1960). Until 1965 these outlays were exceeded by cash flow, but starting with that year and through the rest of the decade gross capital expenditures began to run ahead of cash flow. For example, in 1966 cash flow amounted to $1.4 billion but capital outlays were $2 billion. This imbalance between cash generation and capital investment forced the railroads to increase their borrowings in the market. Outstanding equipment obligations increased steeply (up by almost $700 million in 1966 alone), exceeding $4 billion at the end of 1968 compared with $2.7 billion at the end of 1960. With interest rates on new equipment issues also soaring (they averaged 6.62 per cent in 1968 as contrasted with less than 4.5 per cent earlier in

the 1960's), railroad fixed charges climbed rapidly, reaching $589 million in 1970 or $216 million higher than in 1960. In addition to the rising costs of their own investments, the railroads have also been paying increasing amounts for the rental of equipment. This reflects the investments made by non-railroad sources and the "rents" are a surrogate for interest. Equipment rental payments amounted to $736 million in 1970, $400 million more than in 1960.

(14) Although the Class I railroads experienced falling ordinary income after 1966, they continued to pay out large amounts of cash dividends on common stock. Although reduced somewhat in 1970, common stock cash dividends nonetheless amounted to $409 million that year—81 per cent ($182 million) *more* than railroad ordinary income. Even acknowledging the intercorporate stockholdings that exist in the railroad industry, in view of the railroads' earnings picture these large cash dividend payments are not fully explicable. Conceivably they may in part reflect the spreading pattern of holding company control of railroads, with the parent or controlling firm dictating cash dividend payments as a way of withdrawing liquidity from the railroad for investment elsewhere. Whatever the explanation, large cash dividend payments have contributed significantly to a weakened industry financial situation.

(15) Although the railroads have made large *gross* capital investments in recent years, their average *net* investment in 1970 was only two per cent higher than in 1960. Allowing for the impact of inflation on rising replacement costs, there has been an actual decline, in constant dollars, in total railroad investment. In fact, the $4.5 billion paid out by the railroads in common stock cash dividends between 1960 and 1970 is more than seven times greater than the increase in average net investment during the same years, this also reflects, given the increases in traffic which have taken place, increasing productivity in the use of rail capital. Using average net investment per originated ton as an index, productivity increased from 100 in 1960 to 117.8 in 1970. The pattern has not been uniform, however, with all of the gains coming before 1966. In 1967 and 1968 capital productivity, measured by this standard, actually fell, and by 1970 it was no better than it had been in 1965.

(16) The creation of railroad holding companies and their diversification into non-rail and non-transport fields has created a regulatory challenge to which there has been a woefully inadequate response. Where a railroad is part of a larger corporate complex, there is a danger that its assets can be siphoned off so as to leave it incapable of providing adequate transportation service. While diversification is not *per se* objectionable, there is sufficient potential for abuse (and some actual evidence of its existence) to warrant closer regulatory surveillance.

(17) Throughout most of the 1960's the railroads sustained large and rising losses in their intercity passenger operations. The solely-related passenger service deficit climbed from $9 million in 1963 to $138 million in 1967 and an estimated $250 million in 1970. This is a fact of large economic consequence however one views the role of the railroads in contributing to the decline in patronage. Most railroads have taken advantage of the Railroad Passenger Service Act of 1970 and have opted to turn over their intercity passenger service obligations to AMTRAK in exchange for payments set by the law. For those railroads over which AMTRAK operates this will turn what had usually been a deficit operation into a probable net generator of cash. This is of substantial benefit to the railroads.

EFFICIENCY AND SERVICE

(18) There are unmistakable signs that railroad service, in general, has deteriorated, in speed and particularly in reliability. This has been a major handicap to the railroads in their ability to compete for higher-valued, higher-yielding manufactured goods traffic. Company distribution managers are placing growing emphasis on their total costs and their ability to fit transportation movements into an integrated manufacturing and marketing system. This puts a premium on modal reliability and helps explain why truck movements have grown so sizably. Shippers appear to be prepared to pay approximately 20 per cent more for truck transportation because of its greater predictability. This

has allowed the trucks to divert large amounts of higher-valued manufactured goods traffic, over relatively long distances, and even where the weight ratio of the commodity would appear to make rail movement more desirable.

(19) Since the great bulk of gross capital investment by the Class I railroads is in equipment (with freight cars accounting for half the total), railroad efficiency is largely determined by the intensity with which rolling stock, especially freight cars, is utilized to generate revenue. By some tests there appears to have been improved utilization of freight cars in the last ten years, but close examination reveals that there has been little, if any, actual improvement. For example, net ton-miles per loaded car-mile, one frequently mentioned standard, shows an increase from 34.0 in 1960 to 43.5 in 1968, a seemingly significant nine per cent gain (averaging over one per cent a year). Analysis reveals that this gain is mostly attributable to an increase in average freight car load and a lengthening in the distance of the average haul rather than to better car utilization by the railroads (i.e., it is demand-determined). Trips per year for freight cars have risen only slightly, up from 19.1 in 1960 to 19.8 in 1969 (for some types of cars there have been greater increases, of course). Since the average system length of haul is now 499 miles and average freight train speed is about 20 miles per hour, a car could complete its haul in approximately one day. With an average of less than 20 trips per year, average revenue utilization per freight car is only about five percent of its potential (365 divided by 19.8). This low rate of utilization is just about the same as it was a decade ago.

(20) The tendency toward larger freight cars and an increasing length of haul has resulted in certain service deficiencies. Thus, for example, while the average car is traveling farther and carrying more (when loaded), it recorded about the same number of trips in 1970 as in 1960. Again, while the average freight train is heavier, and while it is traveling a greater distance, fewer trains are being made up for line haul operations.

(21) The speed of the average freight train has remained unchanged over the course of the decade. Despite heavier trains, the use of more powerful locomotives has kept train speeds from slowing. However, with the average length of haul increasing, the absence of any increase in train speed has resulted in longer trip times. Moreover, the extra time consumed in loading and unloading larger and heavier freight cars is not being made up by any increase in point-to-point movement speeds.

(22) While there has been no change in the absolute number of loaded car-miles since the early 1960's, there has been a drop of almost seven per cent in the percentage of total car-miles that are loaded. Taken together, these two measures indicate that there has been an increase in empty back-hauls, probably resulting from the introduction of unit-trains and the use of other specialized (and often shipper-committed) equipment. One implication is that by being more responsive to the demands of particular types of shippers and supplying them with specialized equipment, the railroads have suffered penalties in efficiency and capital productivity.

(23) The changing character of technology and the mix of the economy means that there must be aggressive marketing of carefully refined services if the railroads are to expand and play their appropriate role in the nation's transportation system. This will demand a greater willingness on the part of management to experiment and innovate in rates and other areas. Much can be done under existing law, but if a climate truly favorable to innovation is to be created changes in law and regulatory procedure are called for. There must be a broader economic range within which rates can be revised, sounder cost standards, more certainty as to the applicable cost criteria, and quicker regulatory response to specific rate proposals.

INVESTMENT

(24) Productivity in railroading of capital and labor provides some of the most important clues as to the underlying problems of the industry. Focusing on the 1960's, a key break point comes at the middle of the decade. In the first half there were substantial gains in capital productivity (more

physical output and more net revenue were being derived per dollar of investment). Coupled with gains in labor productivity, with output per man-hour rising at an annual average rate of six per cent and with declines in the labor share of revenue, these improvements in capital utilization helped increase earnings. In the later years, however, there was significant deterioration in these key financial measures. Capital productivity declined (especially when investment is measured against net railway operating income and income available for fixed charges) and the labor distributional share rose, despite continued advances in labor output per man-hour. Contributing significantly to the decline in capital productivity was an erosion in the rate of utilization of freight cars, with even the small gains in freight car efficiency experienced earlier in the decade not matched in the later years. Better utilization of freight cars, which represent the principal form of current investment by the industry, is probably the industry's number one challenge, because gains in utilization are of critical importance to broader marketing of rail service (notably for manufactured goods), reduced investment requirements, and enhanced financial strength.

(25) In their capital expenditures the railroads have placed primary emphasis on the purchase of new rolling stock and the improvement of roadway and structures. Relatively little investment has been made in capital items such as telecommunications facilities and computers that might permit better use of the vast existing rolling stock and roadway investment. With low and only slowly rising rates of capital productivity, relatively greater concentration on such infrastructure items could yield high marginal returns on investment. There are several possible explanations for the failure to concentrate more attention on such opportunities. Some relate to management attitude, others to the greater ease with which funds can be obtained from lenders for high-security rolling stock investments. At best these are only partial and inadequate answers.

(26) Rail service is becoming increasingly specialized, far better attuned to the needs of large shippers than the more general requirements of small users. This is revealed in freight car data, by type and ownership. Today almost 20 per cent of the freight cars are owned by a shipper or car company, as compared with only 14 per cent in 1960. Moreover, as the total number of cars in freight service has declined (down from 1,965,486 in 1960 to 1,782,022 in 1970), they have become more specialized in type. The number of boxcars mostly owned by the railroads, has fallen from 637,829 in 1960 to 546,905. This actually understates the change since nearly a third are now specially-equipped and not available for general purposes. Where the fleet has expanded (and where non-rail owners are concentrated) is in special purpose categories (e.g., equipped flat cars, rack cars, covered hoppers), with features designed to accommodate the demands of particular shippers. Not only are most of these cars not adaptable to general usage, but many in fact are dedicated to and under the de facto control of certain shippers. Increasingly what this has meant is that the railroads have become less a form of public carriage than a quasi-private form of private or contract transportation.

(27) Railroad installations of new rail and crossties slowed during the 1960's but from this it cannot necessarily be inferred that there is "inadequate" investment in track maintenance and replenishment. The rate of tie installations and the miles of new rail put in place have declined below the number required if *all* railroad track were to be rejuvenated and maintained at the same level of quality. This, though, would be an artificial standard; a sounder and more practical criterion would take into account the pertinent level of track usage. Statistics suggest the quality of main lines has been considerably improved. While the average weight per yard of rail is now about 108 pounds, up only slightly from 106 pounds in 1960, more than 63,000 miles of track has an average weight of 130 pounds or over, up 10,000 miles from 1960. Moreover, more than 40,000 miles of road are now under centralized traffic control, a gain of 12,000 miles since 1960. These are substantial improvements but the investment they have called for indicates that secondary track maintenance has been greatly reduced.

(28) There are great variations in the degree to which the 206,400 miles of railroad line in the United States are used. No completely reliable data are available, but the Department of Transportation estimates that ten per cent of rail

line accounts for only 0.5 per cent of total rail tonnage. The Penn Central says that more than 90 per cent of its traffic is handled on about 60 per cent of its trackage. In the Granger area of the Middle West and along the lines between Council Bluffs and Chicago there are density differences of comparable degree. While there are important distinctions between road and region, reflecting the way a system was built and the changing patterns of demand, unquestionably there is a need to relate line and track capacity more closely to current needs. This would enable the railroads to better concentrate their efforts and increase the effectiveness of their investment and service.

PUBLIC POLICY

(29) Although vast amounts of rail transport information are regularly obtained by the ICC in the form of statistical and financial data, much of it is of limited value and some of it is useless in assessing the transportation efficiency and financial health of the industry and individual railroads. Many types of information that would be far more valuable, dealing with more valid economic conceptions of costs, quality of service, traffic mix, capital utilization, labor productivity, and financial dealings between carriers and related or controlling firms, are either not collected or are gathered only sporadically or tardily. There is a compelling need for a complete overhaul of the government's information gathering activities as they pertain to the railroads (and to the other modes as well), particularly with respect to performance, efficiency, and economic posture.

(30) Traditional government efforts to deal with the railroad problem—through regulation, financial assistance, or otherwise—have placed little emphasis on the performance of the industry as a transporter. Rate applications, merger proposals, or loan applications have typically been approved and other action taken without any meaningful examination of the likely impact on service or efficiency. Likewise there has been no follow-up—no assessments of the consequences of past decisions. This essentially static and unsystematic approach has therefore failed to arrest deteriorating performance. Since the regulatory process does not at present relate particular actions to performance objectives or consider the impact of specific investments or rate proposals on earnings, there has been no incentive for the railroads to change operating practices to bring greater service effectiveness or to more refined investment choices. In the future all types of government action that affect the railroads, whether in the form of regulation or otherwise, should be tested by and based upon their effect on railroad performance.

(31) The value of mergers in improving railroad efficiency, eliminating redundant capacity, and increasing carrier earnings and financial strength has not been demonstrated. With occasional exceptions rail mergers consummated since 1958 have generally fallen far short of their claimed cost savings. By expanding the size of the surviving firm and straining already overtaxed managerial capacity many mergers have led to decreased efficiency and a weaker financial posture. In considering the mergers that have come before it, the ICC has failed to probe cost savings claims sufficiently and to consider the effect of a particular merger on other railroads and on the overall rail transport system. An intensive independent investigation by the Commission must be made of the probable effects of a merger coupled with an assessment of alternative ways short of merger to achieve benefits. Ultimately a change in the law may be required that places a heavier legal burden on applicants to demonstrate that merger will produce substantial transportation benefits and that specifically obligates the Commission to consider a particular merger in light of its consequences for rail transportation as a whole.

(32) Despite its many complexities, the freight car "shortage" relates to two basic concepts: first, the actual number of cars, and second, the utilization and availability of those cars. In large measure (general purpose box cars represent the chief exception), the growth of shipper and leasing company supplied cars has greatly alleviated the problem of providing actual units. It is in the area of utilization—which involves making available the proper number of cars at the right place and time—that serious deficiencies remain. Govern-

ment action to assist the industry in alleviating car shortages, therefore, is likely to be misdirected if it aims only at increasing equipment supply. More to the point would be an effort by the public sector to aid in the development of an industry-wide car control system designed to improve the distribution and use of available equipment.

(33) Many of the problems of the railroads reflect the lack of a coherent, integrated transportation policy in the United States. Government transportation programs—in regulation, financial aid, infrastructure support, and other areas—have grown up piecemeal over the years. That they are often uneven and sometimes inconsistent is less a surprise than a confirmation of their patchquilt character. Because government railroad policy has grown over a century, rail transportation tends to be most heavily burdened and least favored by existing public policies. Policy changes are needed in such areas as rate regulation (particularly at the Federal but also at the state level) and financial aid that would increase intramodal and intermodal competition and achieve greater uniformity between the modes. Any such changes in policy are unlikely to be made in the short-run and hence their consideration must not be allowed to obscure the fact that the railroads can become more aggressive transport marketers and more efficient operators within the framework of existing law.

AN INTRODUCTION TO "THE RAILROAD PROBLEM"

In most of the discussion devoted to the railroad problem in the United States, there is a continuing tendency to oversimplify. This is itself one of the most important dimensions of the problem. It leads to confusion, misunderstanding, and the pursuit of policy changes which are often merely symptomatic and indeed sometimes irrelevant to the situation.

All too often "the railroad problem" is treated as if there were only a single problem, uniformly applicable to and descriptive of all the railroads in the country. This impression has seriously confounded understanding of the issues. The truth is that there are major differences among individual railroads and regions in terms of financial health, operating characteristics, traffic growth, and adequacy of investment, as well as other factors. If one is to grasp the problem, in all of its complexity, and thus be able to formulate appropriate policy responses, it is critical to appreciate these differences.

Just as there is a tendency to oversimplification in the description of the railroad problem, so too is there a propensity on the part of most of those concerned with the subject to find a single principal explanation. The "devils" are many. Some place the blame on government policy, others point at labor, still others single out railroad management for most of the responsibility. Once the cause of "the problem" is identified, the policy reactions range widely, with pleas for changes in government regulatory policy, for additional government support to compensate for intermodal inequities, for a fundamental overhaul of labor work rules, tighter control of railroad financial practices, and so forth through a litany of well-known proposals.

Such a specification of causes and "solutions" typically leaves out other contributing factors. The changing requirements and demands of shippers, for example, are only rarely mentioned yet they are a powerful shaping influence. Even less attention is commonly given to the shifting composition of the economy, with its impact on the demand for rail transportation. Likewise, the manner in which technology changes the relative quality and price of service and hence the balance among methods of transportation—is only infrequently recognized as a factor of large consequence. All of these forces interacting in an exceedingly complex fashion describe what has happened to the railroads.

This report is designed to review and explain what has happened to the railroads in recent years. Its principal focus is on the post-World War II period and, in particular, on developments in the last decade. The overall objective is to provide information about the many facets of the railroad problem, recognizing that this, in a sense, complicates the matter and makes more difficult, albeit more realistic, the search for new approaches and long-range solutions.

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THE RAILROAD PROBLEM IN PERSPECTIVE

Later sections of this report examine key facets of rail transportation in the United States since 1929, with principal emphasis on the period 1960–1970. Although each section deals with an important facet of the problem, the necessary descriptive and statistical detail creates the risk that sight will be lost of the relationships among the various ingredients. It would be useful at the outset, therefore, to survey very broadly the issues in an effort to provide some larger canvas against which specific elements can be viewed.

A 40-plus year survey of the American railroads shows an industry that has fully matured and shows some signs of decline. In 1929 the railroads were the country's dominant form of commercial transportation, hauling most of the freight and moving most of the people traveling by public means between cities. Reflecting their preeminent transport role the railroads were generally in sound financial health, with their earnings making their debt and equity securities widely respected forms of investment.

By 1970 (the last full year for which complete data were available when this report was in preparation) the posture of the railroads was radically different. Moving only a little more than 40 per cent of the nation's intercity freight and only a tiny fraction of intercity passengers, the railroads were no longer the primary form of transportation in the United States. This is not to say they were unimportant, for it is still true that the railroads haul more freight than any other mode and remain the key form of movement for many commodities. Still, though, it is incontrovertible that their preeminent place has been lost. Their rate of growth lags behind that of the economy as a whole and their share of intercity freight transportation continues to shrink. Earnings have correspondingly deteriorated and by 1970 the Class I roads together reported net (ordinary) income of only $226 million. This is a fourth of their profits in 1929 and half of what it was in 1960. Relative to net investment and net worth, rail profits had sagged markedly and except for well-secured loans (or rental of equipment), the carriers were no longer a favored source of investment.

In reciting such facts the temptation is to run up the danger flag over the entire railroad industry. It is a temptation, however, that must be resisted, for the railroads, though financially troubled, are not in uniformly or generally desperate financial straits. In 1970, a poor year for the railroads because of the recession, the industry's cash flow exceeded $1 billion—hardly a sign of impending doom. Moreover, the severe distress of some of the carriers, such as the Penn Central and other bankrupt roads in the Northeast, obscures the far stronger positions of roads in the South and West. Nonetheless there are clear signs of financial trouble. Rail net working capital fell sharply during the 1960's and the amount of short-term debt has increased. Fixed charges have climbed steeply and, of at least equal importance, the railroads' equipment rental obligations have soared, more than $400 million between 1960 and 1970. With rail capital expenditures having exceeded cash flow in almost every year since 1965, commitments (overt—in the form of debt, and covert—in the form of equipment rentals) have grown sizably.

As one probes for the causes of this change in circumstance—from one of financial strength at the end of the 1920's to financial uncertainly at the end of the 1970's—the pertinent factors fall into two major groups. The first consists of forces external to the industry, the second is made up of factors

largely within the control of railroad management. The two cannot be completely isolated, however, and indeed much of the story of what has happened in railroading in the last four decades is found in the response to changing economic, technological, and competitive forces. This is not just a question for management, though, for public policy, notably regulation, has limited some types of responses and conditioned the environment in a manner that has been less favorable to innovation than the occasion has required.

Looking first at the external forces, the American economy has undergone major changes that have had a profound impact on the railroads. The economy has grown, though unevenly (and the railroads, like most of transportation, remain highly sensitive to cyclical gyrations), but most importantly it has changed (and will continue to change) significantly in its composition. The mining/forestry/agricultural sectors, which have long been the primary generators of rail freight traffic, have declined in relative importance, with their rates of growth generally lagging behind the overall rate of economic expansion. Faster rates of growth have come in manufacturing, but the railroads have been unable to adjust their service to attract this traffic (and revenue) needed to offset the relative losses sustained due to the slower growth in the low-value bulk-goods sectors.

Meanwhile, other modes of transportation—in part because of their technological advances, in part because of the provision of government infrastructure—have provided increasingly tough competition for the railroads. The inland waterway operators and the pipelines have diverted some bulk traffic and the trucks have taken a large share of higher-valued manufactured goods traffic. Pinched from both sides, the railroads' position has been weakened, with the greatest harm coming in the manufactured goods area since here the rates of growth in output (and thus in traffic) have been the fastest (and promise to be so in the future) and the yields are the most substantial. Here also, though, competition is intense because service factors (speed, schedule reliability, etc.) are substantial, often even more so than tariffs. This test has become all the more difficult for the railroads as the technological and geographic texture of the economy has been altered, affecting intramodal as well as intermodal transport relationships. Patterns of output have changed, as with coal production, and in its share of the economy the Northeast has lost ground to the South and West. For some railroads this has been markedly debilitating, for others it has been a key to expansion. Changing technology has had a different sort of effect, reducing the demand for transportation through new production techniques and the substitution of lower-weight commodities.

All of these changes have presented the railroads with new challenges, requiring innovative responses that often have not been forthcoming. A partial (and only a partial) explanation for this is found in government policy, which in this century has tended to favor non-rail transportation and perpetuate a regulatory climate that is hostile to experimentation. Water, air, and highway transport have been substantially aided through public investment, at little or no user cost, in infrastructure systems (waterways, airports and airways, highways). Not only have the railroads had to make such investments on their own, but, more importantly, they have had to tackle what is essentially a system problem through piecemeal investment approaches. This has hampered them because it has prevented the development of a truly integrated and efficient fixed-capital system (track, terminals and yards, telecommunications and control facilities, etc.).

On the regulatory side existing government controls, at the State as well as the Federal level, continue to be more oriented to the protection of the transport status quo than to the creation of an environment favorable to change. While the initiative inevitably must lie with the railroads, their growth depends on their ability to compete more effectively with the other modes. This demands more sophisticated marketing, more aggressive rate-setting and the inauguration of service innovations. Such approaches require a sympathetic climate, one that reacts promptly to proposals and that reflects a willingness

to permit experimentation. Existing regulation is almost a contradiction of these essential features. It is slow, cumbersome, passive, and protective—qualities that reflect deeply ingrained legal standards, cumulative regulatory attitudes, and a status quo outlook that permeates the entire transport environment.

As important as outside factors are, many of the causes are to be found within the industry itself. Given the changes in the composition of the economy and in technology that have taken place, it was inevitable that the railroads would see their share of the intercity transport market decline. Still, there is good reason to think that it has deteriorated more than would have been the case if there had been a closer tailoring of service and rates to evolving market conditions. On many products carried in large volume by the railroads, rates appear barely to cover costs, let alone reflect demand considerations. In other areas much traffic has been lost to other modes, not because of their inherent superiority, but because the combination of rates and services offered by the railroads has been inferior. This has been particularly true in the manufactured goods sector where other modes, notably trucks, have prospered as a consequence of rail service shortcomings.

The question of service has its roots in efficiency and even more fundamentally in the utilization of capital. It is here in fact where the financial as well as the marketing implications have been the most pronounced. Ordinary income, for example, fell steeply by 49 per cent, between 1960 and 1970. However, in this ten-year period the rail share of intercity freight traffic fell only from 44 to 40 per cent and net operating revenue (the difference between operating revenue and operating expenses) actually rose, by almost 20 per cent. The principal explanations for the gap between rising net operating revenue and sharply falling ordinary income are found in those factors relating to investment. In 1960–1970 the railroads' aggregate capital outlays totaled more than $14 billion. After 1965 these outlays exceeded cash flow, which meant increased borrowing (at rising interest rates) and greater reliance on the lease of equipment. The resulting increases in fixed charges (up $216 million) and equipment rentals (up $415 million) combined to produce the sharp reduction in ordinary income from $445 million in 1960 to $227 million in 1970.

Because the railroads are such a highly capital intensive industry the productivity of investment becomes the key to the industry's financial position. The pattern of the 1960's illustrates the point. From about 1960 through the middle of the decade railroad capital productivity improved, albeit slowly, with more output and more revenue being squeezed out of the investment dollar. Moreover, as capital was substituted for labor, labor productivity also gained and the share of revenue going to labor declined, leaving a bigger distributional share for fixed charges that contributed to rising earnings.

After 1966, however, there were reverses on all fronts related to productivity. The economy began to slow and just as it did the railroads sought and won sizable general rate increases. The effect of these two forces was a reduction in rail traffic expansion. At the same time, rail capital outlays continued at a substantial level, but unlike the early part of the 1960's, productivity slumped badly. The labor share began to rise and on the capital side, instead of getting more from their investment, the railroads began to get less. In 1966, for example, the ratio of rail net investment to net railway operating income was 181 per cent of the 1960 base, but by 1969 it had fallen to 110 and by 1970 it was down to 81.

To a considerable extent railroad capital productivity is a study in freight car utilization since freight cars constitute the biggest continuing form of new investment. In this critical area utilization has improved slowly and sporadically. During the 1960's, for example, net ton miles per freight car day, a commonly-used index, rose at an annual average rate of about three per cent (but the gains from 1967–1970 were only about half those in 1960–1966). Significantly most of this improvement, modest as it was, came from increases in average car size and in the length of the average haul rather than from better management of the freight car fleet itself. Indeed by several tests freight cars were being used less intensively in 1970 than in 1960. Turnaround time in 1970

was about the same as in 1960, the proportion of empty to loaded car miles had gone up, and average train speed had remained constant. It is striking that in the course of a year the average freight car covers only about 20,000 miles in revenue service (a highway truck trailer covers more than three times as many miles) and is generating freight revenue only about five per cent of the time.

Poor utilization of freight cars brings us back to the issue of marketing, thus demonstrating the interdependence of the railroad problem. One key reason why shippers, particularly those engaged in the movement of higher-valued products, fail to use rail service is that they find it unreliable, slow, and tinged with other cost-increasing characteristics. Car availability cannot be well scheduled, loading and unloading thus become protracted and inefficient, and transit times vary widely from estimates. The evidence is that these conditions stem primarily from deficient management of the fleet, not from a general shortage of rolling stock. The shipper's aim to have greater reliability in car supply and quicker turnaround is but the complement of the railroads' necessity of gaining better utilization and improved productivity from their investment. Improved management of capital—putting it to more intensive use—is as essential to better railroad earnings as it is to the broader marketing of rail service. This consideration cannot, though, be separated from questions of rate-setting and regulatory policy, for without finer tuning of rates and a regulatory climate conducive to innovation, the railroads cannot make the changes necessary to improved investment utilization and enhanced service quality.

This introductory review will serve to provide a larger context in which to view the following assessments of more specific dimensions of the railroad problem. The following section looks at the changing economic environment, with the succeeding sections examining railroad revenue and earnings, investment, efficiency, marketing, and public policy.

LONG-RUN TRENDS IN RAIL TRANSPORTATION: THE SHAPING FORCES

To find out how the nation's railroads reached the position they are in today requires at the outset a long-term assessment of trends in the economy and in the demand for rail transportation. In the transportation sector major changes rarely happen quickly. Investments are large and substantially fixed in character, particularly in the development of the necessary infrastructure. It takes years, and often decades, to develop even a single transportation element, whether it be a railroad line, an inland waterway, a highway complex, a pipeline, or a system of airports and airways. So large are these investments that they influence the use of land, the location of industry, the shape of the applicable market area, and other dimensions of economic and social activity.

Powerful though the impact of transportation on the economy and the society is, transportation remains a service function. It must respond to and inevitably be affected by changes in the economy, in the location of population, and in the technological environment. No transportation mode is immune from these larger shaping forces and to a considerable extent the continued vitality of any single transportation sector depends on its ability to adjust to changing circumstances. For some change means expansion, for others contraction, but for all it necessitates constant adjustment.

To see how the railroads have been affected by and have adapted to a changing nation calls for a look at what has been happening in the economy. In 1929, the railroads were the nation's principal form of transportation, hauling about 75 per cent of intercity freight and were the principal form of public travel outside of urban areas. That year the railroads originated 1.3 billion tons of freight, nearly as much as in 1970. From a financial standpoint 1929 was a distinctly profitable year. Railroad net income was nearly $900 million, an amount exceeded recently in only two years (1955 and 1966) despite depreciation of the dollar.

Today, the railroads have lost their preeminent role in American transportation. They account for only 40 per cent of intercity freight ton miles; they are almost completely out of the intercity rail passenger business (except, of course, insofar as they provide operational support for AMTRAK); and, as a group, their earnings and financial position have deteriorated.

OVERALL ECONOMIC GROWTH AND TRANSPORT DEMAND

To explain what has happened in the 43 years between 1929 and 1972, one must look to a number of factors, among which many of the more important are found in the changing pattern of the U.S. economy. In the aggregate, the economy has grown rapidly (though unsteadily), but its makeup has been materially altered and in a way that has been unfavorable from the standpoint of the railroads. Growth, cyclical instability, and change have been the primary economic forces at work.

The American economy, though expanding substantially since the end of World War II (the real rate of GNP growth has averaged nearly four per cent a year since 1947), has followed an uncertain course. This, too, severely affects all forms of transportation, particularly the railroads. In the last 25 years there have been five recessions—in 1948–1949, 1953–1954, 1957–1958, 1960–1961, and 1969–1970. In each the economy has slowed sharply or actually contracted and in each case there has been a decline, of even more pronounced character, in freight transportation. The volume of intercity freight movement fell during

each of the post-World War II recessions. The cyclical impact was more severely felt by the railroads than by the other modes. In 1957–1958, for example, the GNP declined about one per cent; intercity freight ton-miles, however, declined 13 per cent and railroad ton-miles fell by 10 per cent.

The more recent recession is but another vivid illustration of this phenomenon. When the economy began to slow late in 1968 and when it finally entered a period of outright recession in late 1969, railroad traffic fell off markedly. Revenue car loadings declined in 1969 and then fell even more sharply in 1970. As will be noted in later sections of this report, the effects were even more pronounced in terms of revenue, earnings, and finance. One important lesson of this cyclical experience is that great care must be taken in inferring from short-run circumstances any major long-term implications. Just as in the case of the airlines, the railroads are hurt badly by recession, but as the economy again begins to expand railroad net revenue and earnings climb quickly.

From the standpoint of overall growth, the American economy, as measured in real 1958 dollars, has increased more than three and a half times in size since 1929. Despite an increase in population of about 85 million people, per capita disposable personal income has more than doubled. With improved productivity and with additional investment, the value added by manufacturing has increased nearly seven times (in current dollars) since 1929. Industrial production has expanded more than four times. As will be noted below, this record, though impressive when measured in GNP terms, masks important changes in its composition.

TABLE 1.—GROSS NATIONAL PRODUCT AND INTERCITY RAIL FREIGHT TRAFFIC, SELECTED YEARS, 1939–70

Year	Gross national product		Industrial production		Total intercity freight ton-miles		Railroad originated tonnage		Railroad revenue ton-miles		Rail share of intercity freight ton-miles (percent)
	Billions	1947=100	1967=100	1947=100	Billions	1947=100	Millions	1947=100	Millions	1947=100	
1970	720.0	232	106.0	254.8	1,925	188.9	1,457	94.7	762,431	116.4	40.1
1969	724.7	234	109.3	262.7	1,901	186.6	1,473	95.8	767,841	117.3	41.0
1968	707.2	228	104.7	251.7	1,834	180.0	1,431	93.4	744,023	113.6	41.2
1967	675.2	218	100.0	240.4	1,765	173.2	1,408	91.6	719,498	109.9	41.4
1966	658.1	212	98.9	237.7	1,732	170.0	1,449	94.2	738,395	112.8	43.0
1965	617.8	199	90.7	218.0	1,648	161.7	1,387	90.2	697,878	106.6	43.3
1964	581.1	187	83.7	201.2	1,536	150.7	1,355	88.1	658,639	100.6	43.2
1963	551.0	178	78.6	188.9	1,463	143.6	1,285	83.6	621,737	95.0	43.3
1962	529.8	171	74.8	179.8	1,393	136.7	1 234	80.2	592,862	90.6	43.8
1961	497.2	160	69.4	166.8	1,327	130.2	1,194	77.6	563,361	86.1	43.5
1960	487.7	157	68.8	165.4	1,326	130.1	1,241	80.7	572,309	87.4	44.1
1959	475.9	154	66.8	160.6	1,295	127.1	1,232	81.1	575,529	87.9	45.3
1958	447.3	145	59.3	142.5	1,215	119.2	1,190	77.4	551,667	84.3	46.0
1957	452.5	146	63.7	153.1	1,352	132.7	1,380	89.7	618,194	94.4	46.9
1956	446.1	144	63.2	151.9	1,360	133.5	1,447	94.1	647,077	98.8	48.4
1955	438.0	141	61.1	146.9	1,278	125.4	1,396	90.8	623,615	95.3	49.5
1954	407.0	132	54.3	130.5	1,124	110.3	1,224	79.6	549,259	83.9	49.6
1953	412.8	133	57.7	138.7	1,204	118.1	1,384	90.0	605,813	92.5	51.0
1952	395.1	128	53.3	128.1	1,144	112.3	1,383	89.1	614,754	93.9	54.4
1951	383.4	124	51.4	123.6	1,178	115.6	1,477	96.0	646.620	98.8	55.6
1950	355.3	115	47.4	113.9	1,063	104.3	1,354	88.0	588,578	89.9	56.2
1949	324.1	105	40.9	98.3	916	89.9	1,227	79.8	526,500	80.4	58.3
1948	323.7	105	43.3	104.1	1,045	102.6	1,507	98.0	637,917	97.4	61.9
1947	309.9	100	41.6	100.0	1,019	100.0	1,538	100.0	654,728	100.0	65.3
1946	312.6	101	37.6	90.4	904	88.7	1,367	88.9	591,982	90.4	66.6
1945	355.2	115	44.6	107.2	1,027	100.8	1,425	92.7	681,001	104.0	67.2
1944	361.3	117	51.7	124.3	1,088	106.8	1,491	97.0	737,246	112.6	68.7
1943	337.1	109	52.4	126.0	1,031	101.2	1,481	96.3	727,075	111.0	71.3
1942	297.8	96	43.8	105.3	929	91.2	1,421	92.4	637,983	97.4	69.5
1941	263.7	85	35.7	85.8	772	75.8	1,228	79.8	475,672	72.7	62.4
1940	227.2	73	27.8	66.8	619	60.8	1,009	65.6	373,253	57.0	61.3
1939	209.4	68	24.2	58.2	544	53.4	902	58.7	333,438	50.9	62.3

Source: Gross National Product and Industrial Production Index—Economic Report of the President, 1971. Railroad Originated Tonnage and Revenue Ton-Miles—Moody's Transportation Manual. Total Intercity Freight Ton-Miles and Rail Share of Intercity Freight Ton-Miles—Transportation Association of America.

Transportation, too, has grown rapidly over the last four decades, but not quite as much as has the economy. Tables 1 and 2 show, for example, that since 1947 the GNP increased 132 per cent through 1970. Intercity freight ton mileage, by all modes, however, increased only 89 per cent. There has been a somewhat closer correlation between intercity freight traffic and the GNP since about 1960, but it is one in which the railroads have not fully participated.

TABLE 2.—RELATIVE SIGNIFICANCE OF TRANSPORTATION IN THE ECONOMY, SELECTED AGGREGATIVE MEASURES, 1950–70

Year	GNP (constant 1958 dollars)	Ton-miles of intercity freight per dollar of GNP (constant dollars)	GNP in billions (current dollars)	Intercity freight revenue per $100 of GNP (current dollars)
1950	355.3	2.992	284.8	----------------
1955	438.0	2.909	398.0	----------------
1960	487.7	2.694	503.7	5.710
1965	617.8	2.651	684.9	5.212
1966	658.1	2.655	749.9	5.233
1967	675.2	2.614	793.9	5.232
1968	706.6	2.601	864.2	4.953
1969	724.7	2.623	929.1	4.983
1970	720.0	2.674	974.1	----------------

Source: Economic Report of the President and Transportation Association of America.

Since 1947, railroad revenue ton-miles, despite an increase in the average length of haul, have increased only about 16 per cent as compared with a growth of 132 per cent (to 1970) in the GNP and 155 per cent in industrial production. With total intercity freight traffic up 89 per cent from 1947 to 1970, the slower growth in railroad freight traffic has led to a large reduction in the rail share of intercity transportation. In 1947 the railroads carried 65 per cent of the nation's intercity freight (measured in ton-miles); by 1954 the rail share had declined below half and then, somewhat more gradually, continued to shrink, so that by 1970 railroads carried only about 40 per cent.[1] During a period, therefore, when freight volume was rising somewhat more slowly (but not much more so) than the economy, the railroads were experiencing a significant deterioration in their share of the nation's freight transportation. Their portion of intercity movements has fallen dramatically in the last 25 years, though the rate of decline slowed considerably during the 1960's.

As for personal travel, the railroads, once the primary form of public carriage, have now essentially left the business. Since the end of World War II, their significance sharply declined. In 1947 they accounted for 47 billion intercity passenger miles; by 1970 they accounted for less than 11 billion, with nearly half of this made up of commutation traffic. The car, the plane (and especially the jet), and, to some extent, the bus have absorbed most of the personal travel market.

CHANGING COMPOSITION OF THE ECONOMY

From the standpoint of freight traffic, the railroads' gradual loss in share is explained, in part, by the changing composition of the economy. In recent decades the mix of the American economy has been greatly altered. This can be seen in several ways, but the basic trends have been a growth in the "software" sectors (services, finance, government),[2] a decline in the relative significance of agriculture and mining, and a shift in the manufacturing category from lower to somewhat more higher valued goods.

[1] For distribution of intercity freight by mode since 1939, see Appendix, Table A–1.
[2] For breakdown of GNP by major sectors, see Appendix, Table A–2.

TABLE 3.—OUTPUT BY MAJOR ECONOMIC SECTORS, BASED ON 1958 PRICES, 1929–70

[Percentage distribution of GPO (GNP=100%)]

Year	Agriculture, forestry, fisheries			Mining	Contract construction	Manufacturing			Transportation			Communications, public utilities			Trade	Finance, insurance, real estate			Services (excl. private households)	Private households	Government			Rest of world	Total GNP
	Total	Farms	Forest., fish.			Total	Durables	Nondurables	Total	Railroads	Other trans.	Total	Communications	Public utilities		Total	Fin., ins.	Real estate			Total	Gen. govt.	Govt. enterprises		
1929	8.6	8.3	0.2	3.9	5.8	25.4	14.6	10.8	4.3	3.3	0.9	2.0	1.2	0.8	19.4	11.6	5.0	6.6	7.5	3.6	7.2	6.2	1.0	0.7	100.0
1948 (old SIC)	6.2	5.9	.3	2.8	4.7	28.8	16.2	12.6	5.5	2.8	2.7	2.9	1.5	1.4	18.1	10.8	2.6	8.2	7.3	2.4	10.1	8.9	1.2	.4	100.0
1948 (current SIC)	6.3	5.9	.4	2.8	4.7	29.1	16.3	12.8	5.5	2.8	2.7	2.9	1.5	1.4	17.4	11.0	2.5	8.5	7.5	2.4	10.1	8.9	1.2	.4	100.0
1950	5.9	5.5	.4	2.6	4.9	29.1	16.7	12.5	5.4	2.4	2.9	3.0	1.5	1.6	18.1	11.2	2.5	8.6	7.0	2.4	10.0	8.8	1.2	.4	100.0
1953	5.2	4.8	.4	2.6	4.8	30.8	18.7	12.1	5.0	2.2	2.8	3.3	1.5	1.8	16.8	11.3	2.5	8.9	6.5	2.2	11.2	10.1	1.1	.3	100.0
1955	5.1	4.8	.3	2.6	4.7	30.3	18.1	12.1	5.0	2.1	2.9	3.8	1.8	2.0	16.9	12.0	2.8	9.2	6.5	2.3	10.3	9.3	1.0	.4	100.0
1957	4.8	4.5	.3	2.7	4.7	29.5	17.2	12.3	4.9	2.0	2.9	4.3	1.9	2.3	16.7	12.5	2.9	9.6	6.8	2.4	10.3	9.3	1.1	.5	100.0
1960	4.7	4.5	.2	2.4	4.3	28.7	16.3	12.4	4.9	1.8	3.1	4.8	2.1	2.7	16.7	13.3	3.2	10.1	7.1	2.5	10.1	9.0	1.1	.5	100.0
1962	4.4	4.2	.2	2.3	4.0	29.3	16.8	12.5	4.7	1.7	3.0	5.0	2.2	2.8	16.5	13.6	3.2	10.4	7.2	2.4	9.9	8.8	1.1	.6	100.0
1963	4.4	4.2	.2	2.4	3.9	29.1	17.0	12.1	4.8	1.7	3.1	5.3	2.3	3.0	16.4	13.7	3.0	10.7	7.2	2.4	9.8	8.7	1.1	.6	100.0
1964	4.1	3.9	.2	2.3	3.9	29.5	17.2	12.3	4.8	1.6	3.2	5.4	2.4	3.0	16.5	13.8	2.9	10.9	7.2	2.4	9.6	8.5	1.1	.7	100.0
1965	4.0	3.8	.2	2.2	3.7	29.9	17.9	12.0	5.0	1.6	3.3	5.4	2.4	3.0	16.2	14.0	2.9	11.1	7.0	2.3	9.4	8.3	1.1	.7	100.0
1966	3.6	----	----	----	3.8	31.3	19.0	12.3	[1] 9.7	----	----	----	----	----	17.0	13.2	----	----	[2] 9.2	----	9.4	----	----	[3] 2.9	100.0
1967	3.7	----	----	----	3.4	30.4	18.3	12.1	[1] 9.8	----	----	----	----	----	16.9	13.6	----	----	[2] 9.4	----	9.7	----	----	[3] 3.0	100.0
1968	3.5	----	----	----	3.4	31.0	18.6	12.4	[1] 10.0	----	----	----	----	----	17.1	13.5	----	----	[2] 9.3	----	9.7	----	----	[3] 2.5	100.0
1969	3.5	----	----	----	3.3	31.2	18.7	12.4	[1] 10.4	----	----	----	----	----	17.3	13.3	----	----	[2] 9.4	----	9.7	----	----	[3] 2.0	100.0
1970	3.5	----	----	----	3.2	30.2	17.8	12.4	[1] 10.7	----	----	----	----	----	17.6	13.5	----	----	[2] 9.5	----	9.7	----	----	[3] 2.1	100.0

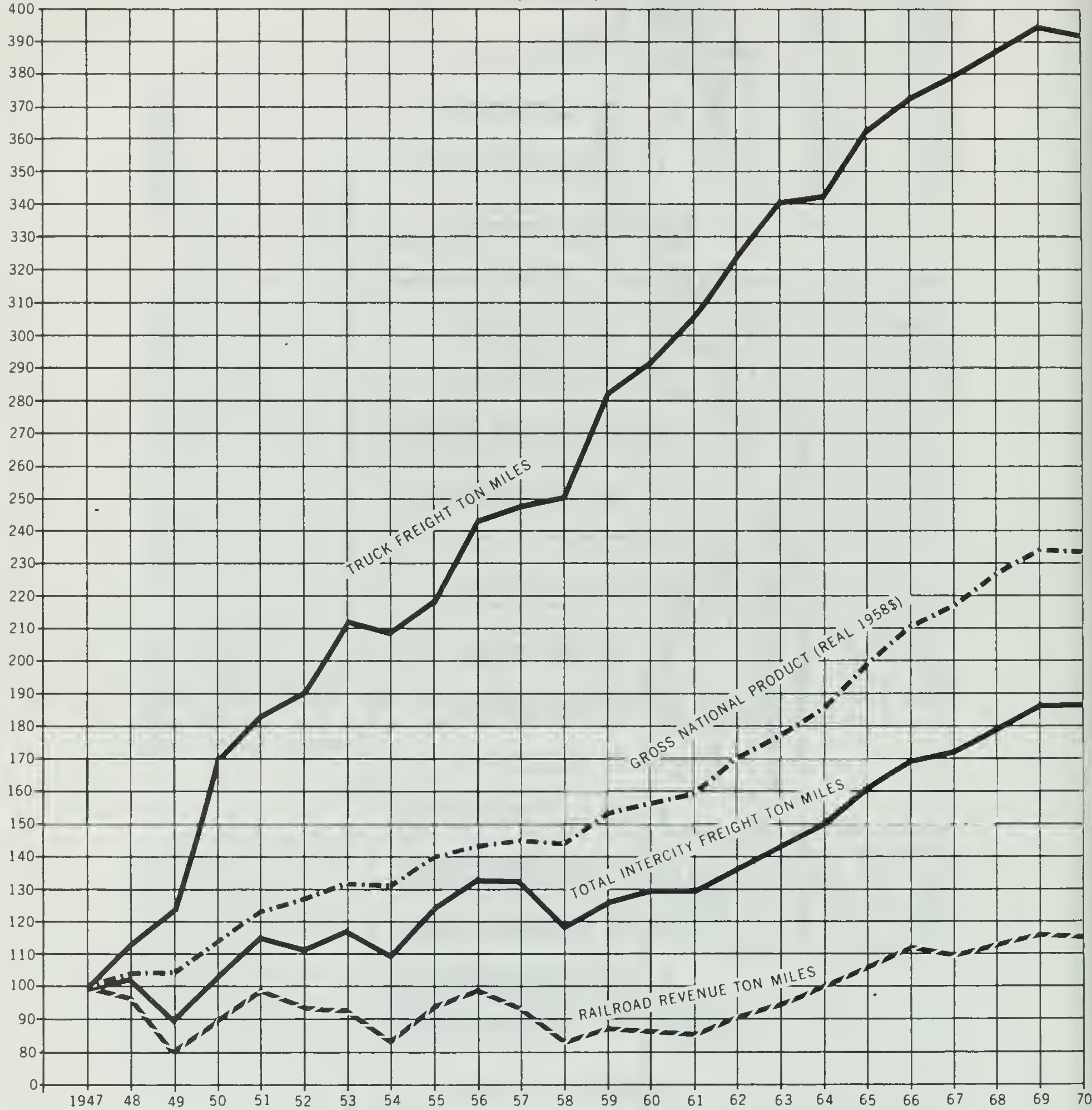
[1] Transportation, communications and utilities.
[2] Including private households.
[3] Including mining.

Source: Economic Report of the President and National Planning Association.

CHART 1

GROSS NATIONAL PRODUCT AND INTERCITY FREIGHT TRAFFIC, BY SELECTED MODE, 1947-1970

(1947=100)



As shown in Table 3, the agriculture, forestry, and mining sectors originated more than 12 per cent of the country's gross product in 1929. The finance, services, and government sectors together originated about 26 per cent. By 1965 the share accounted for by the latter had increased to more than 30 per cent while the agriculture/forestry/mining sectors together were down to only about six per cent, or less than half of what it had been in 1929. The significance of this is that historically the railroads have been heavily dependent on agriculture and mining as sources of traffic. By contrast, the software area creates little direct demand for transportation and practically none for the railroads. To put it differently, those areas of the economy upon which the railroads have been more heavily dependent are now among the more slowly growing while the more actively growing sectors create little demand for rail transportation. This has clearly been one of the more critical external problems for the railroad industry, and projections to 1980 show that it is likely to remain so in the future (see Table 4).

TABLE 4.—PROJECTED RATE OF GROWTH TO 1980 AND DISTRIBUTION OF GROSS PRODUCT ORIGINATING [1], 1965, 1968, PROJECTED TO 1980, BY MAJOR ECONOMIC SECTOR

Major sector	Projected rate of growth 1968-80 period: Services economy: 3-percent unemployment	Services economy: 4-percent unemployment	Durables economy: 3-percent unemployment	Durables economy: 4-percent unemployment	Distribution of gross product originating: 1965	1968	1980: Services economy—3-percent unemployment [2]	1980: Durables economy—3-percent unemployment
Total	4.3	4.2	4.3	4.2	100.0	100.0	100.0	100.0
Agriculture, forestry, fisheries	3.4	3.3	3.2	3.1	3.7	3.1	2.9	2.8
Mining	3.0	2.9	2.9	2.8	1.7	1.6	1.4	1.4
Construction	4.7	4.6	4.9	4.8	5.1	4.6	4.8	4.9
Manufacturing	4.1	4.0	4.4	4.3	28.2	28.5	27.8	28.8
Transportation, communications and public utilities	5.3	5.2	5.2	5.2	8.2	8.5	9.5	9.5
Wholesale and retail trade	4.5	4.5	4.6	4.5	16.5	16.5	17.0	17.0
Finance, insurance, and real estate	5.1	5.0	4.9	4.8	13.4	13.5	14.8	14.5
Services, including household services	4.6	4.5	4.3	4.3	11.0	11.0	11.4	11.1
Government, including government enterprises	2.6	2.5	2.4	2.3	12.1	12.4	10.2	9.9

[1] Gross product originating is the value added by each sector to the total product.
[2] Distribution at 4-percent unemployment is identical.

Note: Detail may not add to total.

Source: The U.S. Economy in 1980, Department of Labor, BLS Bull. 1673, pp. 10 and 11.

The significance of different rates of growth among various parts of the economy can best be appreciated by looking at some key commodities. Table 5 lists those product groups which account for about 90 per cent of rail freight tonnage and for 75 per cent of railroad freight revenue. As one can see most of of these groups have grown only slowly, lagging beyond the overall rate of economic growth.

TABLE 5.—PAST AND FORECAST RATES OF GROWTH IN OUTPUT OF MAJOR COMMODITY SOURCES OF RAIL FREIGHT TONNAGE 1957-80

STCC	Commodity	Share of tonnage, average percentage, 1964-68	Approximate annual average rate of growth: 1957-65 actual	1965-80 forecast [1]
11	Coal	26.3	0.0	1.7
14	Stone	12.5	4.2	4.4
01	Farm commodities	9.2	1.7-2.7	2.6-2.9
10	Metallic ores	8.3	0.1-2.3	2.9-4.9
20	Food products	7.1	4.4	2.9
24	Lumber	6.5	2.3	3.6
33	Primary metal products	6.2	1.9	2.3
32	Cement	5.4	4.0	4.2
28	Chemicals	5.4	6.0-9.0	5.3-6.8
26	Pulp and paper	2.7	4.3	4.8
	GNP		3.9	4.7

[1] Forecasts are based on Labor Department projections for a durable goods economy with 4-percent unemployment. See "The U.S. Economy in 1980," Bureau of Labor Statistics Bull. 1673, table A-11 (1970).

Source: ICC, AAR, Department of Labor.

Take coal as a key example. It accounts for more than one-fourth of rail tonnage and generates about 12 per cent of railroad revenue. Its importance is thus obvious, yet coal production has dwindled. With 1957–1959 equal to 100, U.S. coal production is now only about equal to what it was in 1956 and is far below the production levels achieved in the early post war years 1947–1948 (the index then was approximately 150). One reason for this has been the changing use of energy sources for electricity generation and for other purposes. As a percentage of total energy in North America, Japan, and Western Europe (an appropriately large market since about ten per cent of U.S. production is now exported) coal supplied 55 per cent in 1950, only 37 per cent in 1960 and an estimated 25 per cent in 1970. Future forecasts of coal usage indicate that while aggregate coal consumption will rise in absolute amounts, its contribution to total energy requirements may well continue to fall, though at a slower rate than in the recent past.

The diminishing relative economic significance of the raw materials sectors and the increasing importance of the software areas have left manufacturing with a slightly larger share of total economic activity. In some cases rapid industry growth has been helpful to the railroads because they carry a significant share of the traffic. This would be true of chemicals or paper. On the whole, however, developments have been disadvantageous to rail movement. The key facts relate to the relatively faster rates of growth in industries where the goods produced are usually higher valued. Tables 6 and 7 contain the basic data. These statistics show that the most rapid rates of growth have been in products, such as computers, which are of high value relative to size and bulk and which generate little transport demand relative to their final value.

TABLE 6.—COMPARATIVE GROWTH RATES FOR MAJOR INDUSTRIES, 1947–65 AND PROJECTED 1965–80

[Average annual rates of change of domestic output at producers value in 1968 dollars]

				1965–80			
				Services economy		Durables economy	
Industry name and number	1947–65	1947–57	1957–65	3-percent unemployment	4-percent unemployment	3-percent unemployment	4-percent unemployment
Agriculture, Forestry, and Fisheries	1.7	1.4	2.1	2.9	2.9	2.8	2.7
1. Livestock and livestock products	1.7	1.7	1.7	2.8	2.8	2.7	2.6
2. Other agricultural products	1.7	.9	2.7	3.0	3.0	2.9	2.9
3. Forestry and fishery products	1.8	2.2	1.4	2.0	2.0	2.5	2.4
4. Agricultural, forestry, and fishery services	1.8	2.2	1.4	1.5	1.5	1.5	1.4
Mining	2.2	2.5	1.7	3.4	3.4	3.5	3.4
5. Iron and ferroalloy ores mining	2.7	3.1	2.3	2.5	2.5	3.0	2.9
6. Nonferrous metal ore mining	1.8	3.1	.1	4.8	4.8	5.0	4.9
7. Coal mining	−1.8	−3.1	0	1.8	1.8	1.8	1.7
8. Crude petroleum and natural gas	3.3	4.6	1.8	3.4	3.4	3.4	3.3
9. Stone and clay mining and quarrying	5.3	6.2	4.2	4.2	4.2	4.5	4.4
10. Chemical and fertilizer mineral mining	6.1	6.2	6.1	5.9	5.9	6.0	5.9
Construction	4.7	4.9	4.4	4.2	4.2	4.4	4.4
11. New construction	4.9	5.5	4.1	4.4	4.4	4.8	4.7
12. Maintenance and repair construction	4.2	2.9	5.9	3.2	3.2	3.2	3.1
Manufacturing	3.8	3.5	4.1	4.2	4.2	4.5	4.4
13. Ordnance and accessories	7.4	14.1	−.4	3.2	3.2	5.7	5.6
14. Food and kindred products	2.4	2.4	2.6	3.3	3.3	3.2	3.1
15. Tobacco manufacturers	1.3	.3	2.4	2.3	2.3	2.2	2.1
16. Broad and narrow fabrics, yarn, and thread mills	2.4	1.3	3.7	3.7	3.7	3.7	3.6
17. Miscellaneous textile goods and floor coverings	4.4	2.5	6.9	4.2	4.1	4.3	4.2
18. Apparel	3.4	3.4	3.4	3.8	3.7	3.5	3.5
19. Miscellaneous fabricated textile products	3.8	3.6	3.9	3.7	3.6	3.6	3.5
20. Lumber and wood products, except containers	2.3	1.4	3.3	3.5	3.4	3.7	3.6
21. Wooden containers	−2.1	−3.6	−.2	.3	.2	.4	.3
22. Household furniture	3.5	3.7	3.4	5.0	4.9	5.3	5.2
23. Other furniture and fixtures	3.4	2.4	4.6	5.4	5.3	5.4	5.4
24. Paper and allied products, except container	3.9	3.6	4.3	4.8	4.7	4.8	4.7
25. Paperboard containers, and boxes	4.7	4.5	4.9	4.4	4.3	4.4	4.3
26. Printing and publishing	3.3	3.0	3.6	4.4	4.3	4.3	4.3
27. Chemicals and selected chemical products	6.8	7.5	6.0	5.4	5.3	5.4	5.3
28. Plastics and synthetic materials	9.3	9.6	9.0	6.8	6.7	6.8	6.8

TABLE 6—Continued

Industry name and number	1947–65	1947–57	1957–65	1965–80 Services economy 3-percent unemployment	1965–80 Services economy 4-percent unemployment	1965–80 Durable economy 3-percent unemployment	1965–80 Durable economy 4-percent unemployment
29. Drugs, cleaning and toilet preparations	7.1	7.1	7.0	6.0	5.9	5.7	5.6
30. Paints and allied products	2.6	1.2	4.3	4.3	4.2	4.4	4.3
31. Petroleum refining and related industries	3.9	4.8	2.8	3.5	3.4	3.4	3.3
32. Rubber and miscellaneous plastics products	4.8	2.9	7.3	6.3	6.2	6.4	6.4
33. Leather tanning and industrial leather products	−1.5	−2.2	−.8	−.3	−.3	−.4	−.4
34. Footwear and other leather products	.5	.4	.6	1.4	1.4	1.2	1.2
35. Glass and glass products	3.0	1.9	4.4	3.9	3.8	4.0	3.9
36. Stone and clay products	5.0	5.9	3.8	4.6	4.5	4.8	4.8
37. Primary iron and steel manufacturing	1.6	1.3	1.9	1.9	1.8	2.2	2.2
38. Primary nonferrous metals manufacturing	3.7	3.1	4.3	5.3	5.2	5.7	5.6
39. Metal containers	3.1	3.3	2.9	3.3	3.2	3.1	3.0
40. Heating, plumbing, and structural metal products	3.8	4.7	2.7	4.2	4.1	4.5	4.4
41. Stampings, screw machine products, and bolts	1.7	1.0	2.7	3.7	3.7	4.1	4.0
42. Other fabricated metal products	3.2	2.8	3.8	3.9	3.8	4.1	4.0
43. Engines and turbines	3.0	2.4	3.9	4.2	4.1	4.6	4.5
44. Farm machinery and equipment	1.7	.2	3.6	3.4	3.4	3.7	3.7
45. Construction, mining and oil field machinery	2.1	1.8	2.4	3.5	3.4	3.8	3.8
46. Materials handling machinery and equipment	3.4	3.0	4.1	4.2	4.1	4.5	4.5
47. Metalworking machinery and equipment	2.7	3.1	2.3	3.0	2.9	3.6	3.5
48. Special industry machinery and equipment	1.1	−1.3	4.2	4.0	3.9	4.4	4.3
49. General industrial machinery and equipment	3.4	1.8	5.5	3.4	3.3	3.9	3.9
50. Machine shop products	7.2	8.5	5.6	4.9	4.8	5.5	5.4
51. Office, computing and accounting machines	8.9	7.7	10.5	10.3	10.2	10.9	10.8
52. Service industry machines	4.6	2.6	7.2	6.5	6.4	6.9	6.8
53. Electric industrial equipment and appartus	3.9	4.1	3.6	4.9	4.8	5.5	5.4
54. Household appliances	4.5	2.7	6.8	5.1	5.0	5.4	5.3
55. Electric lighting and wiring equipment	3.3	2.1	5.0	4.7	4.6	5.0	4.9
56. Radio, television, and communication equipment	9.1	9.0	9.1	6.2	6.1	7.0	7.0
57. Electronic components and accessories	13.4	12.0	15.2	8.4	8.4	9.3	9.2
58. Miscellaneous electrical machinery, equipment, and supplies	2.2	.9	3.7	5.5	5.4	5.7	5.6
59. Motor vehicles and equipment	5.3	4.5	6.2	2.9	2.8	3.1	3.1
60. Aircraft and parts	11.1	20.2	.7	2.6	2.6	4.6	4.6
61. Other transportation equipment	2.5	.9	4.5	2.9	2.9	3.7	3.7
62. Scientific and controlling instruments	4.1	4.0	4.2	5.4	5.4	6.1	6.1
63. Optical, ophthalmic, and photographic equipment	6.7	6.4	7.1	8.8	8.8	9.0	8.9
64. Miscellaneous manufacturing	3.4	2.2	5.0	5.6	5.5	5.6	5.5
65. Transportation and warehousing	1.6	.7	2.8	4.0	3.9	4.0	3.9
Communications and public utilities	7.5	8.6	6.0	6.6	6.6	6.6	6.5
66. Communications, excluding radio and TV broadcasting	7.4	7.7	7.1	7.0	6.9	6.9	6.9
67. Radio and TV broadcasting	7.5	10.3	4.1	2.0	1.9	2.1	2.0
68. Electric, gas, water, and sanitary services	7.5	9.0	5.7	6.7	6.6	6.6	6.5
69. Wholesale and retail trade	3.9	3.6	4.4	4.7	4.6	4.7	4.6
Finance, insurance, and real estate	5.1	5.0	5.2	4.8	4.8	4.7	4.6
70. Finance and insurance	4.4	4.2	4.7	4.4	4.3	4.3	4.2
71. Real estate and rental	5.4	5.4	5.4	5.0	4.9	4.8	4.8
Services and miscellaneous	4.0	3.5	4.6	5.5	5.5	5.4	5.3
72. Hotels, personal and repair services, excluding auto	2.8	2.1	3.7	4.6	4.5	4.3	4.3
73. Business services	5.2	5.2	5.3	6.3	6.2	6.4	6.3
74. Research and development	6.4	5.2	7.8	6.0	5.9	6.7	6.7
75. Automobile repair and service	3.0	2.3	3.9	4.8	4.7	4.6	4.6
76. Amusements	.2	−1.5	2.3	4.4	4.3	4.1	4.0
77. Medical, educational services, and nonprofit organizations	5.0	5.0	5.1	5.5	5.4	5.2	5.1
Government enterprises	4.2	3.3	5.3	5.3	5.3	5.2	5.1
78. Federal Government enterprises	5.4	4.9	6.1	5.1	5.0	5.0	4.9
79. State and local government enterprises	3.4	2.3	4.8	5.5	5.4	5.3	5.3

Source: The U.S. Economy in 1980, Department of Labor, BLS Bull. 1673, table A-11.

Input-output analyses of the Department of Commerce show, as an example, that for a given dollar increase in final demand of computers and related products (Row 51, Table 7), there is only a .02833 per cent increase in transport requirements (direct and indirect). By contrast a similar increase in steel output calls for four times as much transportation. As previously noted, however, it is at the high valued, relatively low transport input end of the industrial

spectrum where the most rapid rates of growth generally are likely to come, just as they have in the last several years. Moreover, as goods increase in value and as the significance of transportation in the final price declines, the fastest growing sources of traffic will be exposed to growing intermodal competition. Given these trends it is interesting to recall that truck transportation has doubled its share of intercity freight movement in the last 25 years. For relatively expensive products like TV sets, cigarettes, office machines, electronic components and optical and photographic equipment, where transportation costs are a proportionately smaller share of the delivered price, non-rail modes, like truck and even air, can represent superior alternatives.

TABLE 7.—OUTPUT OF TRANSPORTATION AND WAREHOUSING SECTOR REQUIRED, DIRECTLY AND INDIRECTLY, FOR EACH DOLLAR OF DELIVERY TO FINAL DEMAND BY VARIOUS INDUSTRIES

[In producers' prices]

1	Livestock and livestock products	.05962	43	Engines and turbines	.04519
2	Other agricultural products	.03203	44	Farm machinery and equipment	.05551
3	Forestry and fishery products	.05176	45	Construction, mining and oil field machinery	.04966
4	Agricultural, forestry, and fishery services	.04894	46	Materials handling machinery and equipment	.04963
5	Iron and ferroalloy ores mining	.11195	47	Metalworking machinery and equipment	.03794
6	Nonferrous metal ores mining	.04261	48	Special industry machinery and equipment	.04196
7	Coal mining	.03795	49	General industrial machinery and equipment	.04281
8	Crude petroleum and natural gas	.03689	50	Machine shop products	.04125
9	Stone and clay mining and quarrying	.04034	51	Office, computing and accounting machines	.02833
10	Chemical and fertilizer mineral mining	.07874	52	Service industry machines	.04946
11	New construction	.07079	53	Electric industrial equipment and apparatus	.04288
12	Maintenance and repair construction	.05183	54	Household appliances	.05205
13	Ordnance and accessories	.03132	55	Electric lighting and wiring equipment	.04943
14	Food and kindred products	.07633	56	Radio, television, and communication equipment.	.03081
15	Tobacco manufacturers	.02202	57	Electronic components and accessories	.03844
16	Broad and narrow fabrics, yarn and thread mills	.05366	58	Miscellaneous electrical machinery, equipment and supplies.	.04295
17	Miscellaneous textile goods and floor coverings	.05850	59	Motor vehicles and equipment	.05742
18	Apparel	.03679	60	Aircraft and parts	.03439
19	Miscellaneous fabricated textile products	.04788	61	Other transportation equipment	.05641
20	Lumber and wood products, except containers	.06941	62	Scientific and controlling instruments	.03877
21	Wooden containers	.09664	63	Optical, ophthalmic and photographic equipment.	.03424
22	Household furniture	.05893	64	Miscellaneous manufacturing	.04685
23	Other furniture and fixtures	.05506	65	Transportation and warehousing	1.10440
24	Paper and allied products, except containers	.07337	66	Communications; except radio and TV broadcasting.	.01025
25	Paperboard containers and boxes	.07393	67	Radio and TV broadcasting	.02336
26	Printing and publishing	.04601	68	Electric, gas, water and sanitary services	.04457
27	Chemical and selected chemical products	.06474	69	Wholesale and retail trade	.02263
28	Plastics and synthetic materials	.05760	70	Finance and insurance	.02131
29	Drugs, cleaning and toilet preparations	.05065	71	Real estate and rental	.01482
30	Paints and allied products	.06659	72	Hotels; personal and repair services except Auto.	.02639
31	Petroleum refining and related industries	.07914	73	Business services	.03324
32	Rubber and miscellaneous plastics products	.04924	75	Automobile repair and services	.02612
33	Leather tanning and industrial leather products	.03166	76	Amusements	.02752
34	Footwear and other leather products	.03684	77	Medical, educational services and nonprofit organizations.	.02183
35	Glass and glass products	.04901	78	Federal Government enterprises [1]	.13067
36	Stone and clay products	.08984	79	State and local government enterprises	.03182
37	Primary iron and steel manufacturing	.08653	80	Gross imports of goods and services	.03182
38	Primary nonferrous metal manufacturing	.05795	81	Business travel, entertainment and gifts	.48005
39	Metal containers	.07415	82	Office supplies	.05094
40	Heating, plumbing, and structural metal products	.05978			
41	Stampings, screw machine products, and bolts	.05269			
42	Other fabricated metal products	.05069			

[1] To remove a source of instability in the measurement of total requirements per dollar of delivery to final demand, the Commodity Credit Corporation has been excluded from this industry. The excluded inputs to the CCC from the specified industries are: Industry 2, $636 million; Industry 14, $214 million: Industry 16, $15 million; Industry 65, $642 million; Industry 69, $24 million; and value added, —$1,531 million.

Source: Department of Commerce, Input-Output Study, in Survey of Current Business, November 1969, table 3, pp. 42–47.

In addition to the changing pattern of industrial output, other more subtle economic and technological forces have also been at work that affect transportation. Some of these relate to the way products are made, as with the substitution of lighter-weight components for heavier components. Others involve the location of manufacturing and distribution centers that bring goods closer to final markets. In some instances the "product" itself is altered. Electricity was once generated close to the consuming market, with coal or other energy sources transported to the generating station; now it is becoming common for electricity to be generated close to the source of fuel, with the electricity being "transported" through long-distance transmission lines. In still other cases the change involves the substitution of one transport mode for another, with the user taking advantage of speed/rate/service differentials in a way that alters the mix of transportation services consumed.

Recent studies have attempted to measure the impact of the factors in terms of the transportation implications. One assessment, conducted by Alexander L. Morton, estimated for some 20 industries the "losses in freight traffic" due to the changing composition of final demand and "structural changes" (the substitution of lower-cost inputs). Table 8 sums up the results. Those columns in the table identified as "loss due to changing composition of final demands" show the loss in freight traffic as estimated by the difference between growth in the industry as compared with what would have occurred if the industry shown had grown as rapidly as gross domestic output. The columns headed "loss due to structural change" are based on changes in input-output coefficients between the years in question (i.e., did transport input fall or rise as a factor in output). For the period 1958–1963 freight loss is estimated at about $4 billion, with the dollar amounts varying widely by sector. In some there is an actual increase in transportation requirements (signified by the negative numbers), but in most there is a freight loss. The transportation and warehousing sector itself plays a major role, with more efficient means of distribution reducing this sector's own requirements for transportation services.

TABLE 8.—FREIGHT LOSS DUE TO CHANGING COMPOSITION OF FINAL DEMAND AND STRUCTURAL CHANGE AMONG THE 20 INDUSTRIES WITH THE LARGEST TOTAL TRANSPORTATION REQUIREMENTS[1]

Industry	1947–58 (millions of 1958 dollars)			1958–63 (millions of current dollars)		
	Loss due to changing composition of final demands	Loss due to structural change	Total loss	Loss due to changing composition of final demands	Loss due to structural change	Total loss
Transportation and warehousing	3,492	−115	3,377	1,681	−282	1,399
New construction	−764	634	−130	285	421	706
Food and kindred products	620	151	771	811	403	1,214
Wholesale and retail trade	280	1,055	1,335	7	71	78
Motor vehicles and equipment	174	−11	163	−361	166	−195
Real estate and rental	−135	682	547	−2	175	173
Petroleum refining	−246	121	−125	135	92	227
Medical, educational services and charities	−89	289	200	−87	106	19
Electric, gas, water and sanitary	−212	127	−85	−37	−1	−38
Apparel	76	173	249	49	125	174
Finance and insurance	−15	39	24	−22	143	121
Hotels, lodging and personal services	46	4	50	10	38	48
Drugs, cleaning and toilet preparations	−95	133	38	−28	31	3
Aircraft and parts	−210	61	−149	8	14	22
Radio, TV, and communication equipment	−86	58	−28	−152	110	−42
Maintenance and repair construction	−11	82	71	35	−40	−5
Other transportation equipment	102	−12	90	−6	21	15
Agricultural products[2]	48	146	194	42	17	59
Business services	20	25	45	−67	13	−54
Household furniture	25	53	78	14	18	32
Total	3,020	3,695	6,715	2,315	1,641	3,956

[1] Minus signs indicate a gain.
[2] Exclusive of livestock.

Source: Ph.D. dissertation of Alexander L. Morton, Harvard University.

LOCATIONAL ADJUSTMENTS

The changes in the industrial mix of the economy have been accompanied by important changes in the location of economic activity. This development has also had major transportation ramifications, especially for the railroads. Unlike most of the other modes, they have large, inflexible capital investments. A railroad plant, with its track, terminals, and other investments in fixed locations cannot be shifted about in the short run as demand fluctuates. If there are material alterations in the geographic pattern of economic activity, a railroad can find its investment ill-suited to changed circumstances. Precisely this sort of process has been taking place.

There have been substantial geographic adjustments in all areas of the economy. Consider manufacturing. In 1929 New England and the Mid-Atlantic States together accounted for about 42 per cent of the total value added by manufacturing in the United States. As shown in Table 9, their share had declined below 30 per cent by 1968 as industrial activity sharply increased in other areas of the country, notably in the South and the West. Auto production, once heavily concentrated in Michigan and in surrounding states, has been dispersed, with new assembly plants opened up in the South, the Southwest, and on the West Coast. This, of course, has had major transportation consequences,

but they are most serious in the case of the railroads because so much of their investment is fixed in location. For the railroads serving the Northeast quadrant, diffusion of industrial activity has resulted in slowly growing traffic and, in some cases, an actual decline. Unmistakably, this was one of the principal problems faced by the Penn Central. Finally, just as the changing pattern of the economy has hampered some railroads, it has helped others, with increasing traffic for roads in the South and the West.

TABLE 9.—VALUE ADDED BY MANUFACTURING REGION AS A PERCENT OF TOTAL FOR NATION, 1929–68

Year	United States	New England division	Middle Atlantic division	East North Central division	West North Central division	South Atlantic division	East South Central division	West South Central division	Mountain division	Pacific division
1929	100.0	10.2	31.9	31.3	5.9	7.7	2.9	3.0	1.2	6.0
1939	100.0	10.0	30.2	30.8	5.6	9.2	3.4	3.4	1.1	6.4
1947	100.0	9.2	27.9	31.6	5.5	9.3	3.9	4.1	1.1	7.5
1949	100.0	8.4	27.4	32.5	5.8	9.4	3.8	4.1	1.0	7.6
1950	100.0	8.3	26.2	33.2	5.7	9.4	3.8	4.3	1.2	7.9
1951	100.0	8.3	26.1	32.9	5.6	9.1	3.8	4.7	1.2	8.2
1952	100.0	8.3	26.2	32.5	5.9	8.8	3.7	4.7	1.2	8.7
1953	100.0	8.1	26.0	32.8	5.8	8.8	3.8	4.6	1.2	8.7
1954	100.0	7.8	26.0	31.2	6.1	9.1	4.0	4.9	1.2	9.7
1955	100.0	7.4	24.9	32.1	6.0	9.4	4.2	5.2	1.4	9.5
1956	100.0	7.5	25.1	31.2	5.9	9.3	4.2	5.3	1.5	9.9
1957	100.0	7.3	25.1	30.8	6.0	9.4	4.3	5.4	1.4	10.3
1958	100.0	7.4	24.6	28.9	6.3	10.1	4.5	5.5	1.6	11.1
1959	100.0	7.5	23.9	29.9	6.2	10.3	4.4	5.4	1.5	10.9
1960	100.0	7.5	24.1	29.4	6.1	10.4	4.4	5.4	1.6	11.0
1961	100.0	7.7	23.8	28.7	6.2	10.5	4.5	5.6	1.7	11.2
1962	100.0	7.5	23.3	29.2	6.2	10.7	4.5	5.4	1.8	11.4
1963	100.0	7.1	22.8	29.4	5.7	11.1	4.8	5.7	1.8	11.5
1964	100.0	7.0	22.3	29.5	6.2	11.1	4.9	5.9	1.7	11.3
1965	100.0	7.1	22.5	30.2	6.2	11.1	5.1	5.8	1.6	10.7
1967	100.0	7.2	21.9	28.6	6.4	11.2	5.2	6.3	1.7	11.3
1968	100.0	7.0	21.3	28.6	6.5	11.4	5.4	6.4	1.8	11.6

Source: Bureau of the Census.

Coal traffic illustrates the shifting location of output. In the 1950's, for example, Pennsylvania accounted for nearly 20 per cent of total U.S. bituminous coal production. By 1969, however, Pennsylvania's share had fallen by almost a third. Meanwhile Kentucky had increased its share from about 14 per cent to 20 per cent (Table 10). Not only did this southward shift in the balance of coal production open up coal traffic to other modes, namely inland waterway operators, but it hurt some railroads, like the Penn Central, and helped others, notably those with lines into the lower Appalachian territory.

TABLE 10.—PERCENT OF U.S. BITUMINOUS COAL PRODUCTION, BY SELECTED MAJOR PRODUCING STATES, 1951–69

	1951–55 average	1960	1969
U.S. total	100.0	100.0	100.0
West Virginia	30.0	28.6	25.2
Kentucky	14.4	16.1	19.5
Pennsylvania	19.4	15.7	14.0
Illinois	10.1	11.1	11.5
Other	7.7	8.2	9.1

Source: U.S. Bureau of Mines.

The economic environment in which transportation must subsist has thus undergone radical change in recent decades. For a whole host of reasons the mix and geographic pattern of the American economy have been materially altered. For some modes and for many transportation enterprises this has meant new opportunities for growth and expansion. For others—and specifically for the railroads, notably those in the Northeast—the evolving circumstances are considerably less favorable. Areas of activity best served by rail transportation are generally experiencing slow rates of growth. In the more rapidly growing sectors the transportation market is becoming increasingly competitive, posing difficult new challenges for the railroads. In subsequent sections of this report the performance of the railroad industry is probed in considerable detail, implicitly testing the effectiveness of the way in which the railroads have been able to respond to changing economic circumstances.

RAILROAD FINANCE AND EARNINGS

This section examines the financial condition, earnings, and investments of the Class I railroads, with emphasis on the changes that took place during the 1960's. In carrying out this assessment, information has been developed not only for the railroads as a group but, selectively, for the major regions (East, South, West) and for individual railroads. This has revealed such sharp differences, in both situation and trend, among regions and roads that a cautionary note must be introduced whenever generalizations are made about the nation's railroads.

Indeed, any presentation that lumps together the railroads and attempts to draw conclusions or create impressions about the railroad situation as a whole can be highly deceiving. This is especially so when the objective is to suggest that all railroads are in extreme financial distress. The fact is that while some railroads are in poor financial condition, many others are relatively well off and are likely to experience substantial rates of growth.

To reveal how misleading can be general or aggregated statistics about the railroad industry, one has only to look at the impact of the Penn Central. It bulks so large in the railroad picture, accounting for about ten per cent of total rail traffic, and its performance was so disastrous from the date the merger became effective that it radically distorts industry results. For example, in 1969 railroad net ordinary income fell by $55.2 million; actually, all of this—and then some—was accounted for by the Penn Central, whose income alone fell that year by $80 million. What thus appeared to be a serious decline in rail earnings could more accurately be attributed entirely to the PC. Similarly, between 1969 and 1970 Class I railroad ordinary income fell by $288 million, but $243 million of this (84 per cent of the total) was reported just by the Penn Central. The lesson is that extreme care must be taken in drawing conclusions from consolidated industry statistics. Because of this the material in this section, as well as in other parts of the report, provides disaggregated statistics for key variables.

For the railroads, like any industry or enterprise, financial condition is determined by flows of earnings and capital. The balance sheet sums up the situation at a particular point in time, with the flow data largely explaining the differences that have taken place. It is the actual flows of funds in which we are interested, of course, not the bookkeeping entries that are made to characterize particular items. This is why earnings or reported net income are inadequate bases for evaluation, since they reflect as expenses such things as depreciation which do not in fact involve cash disbursements. The succeeding sections deal, in turn, with flows of earnings, cash flow, and changes in balance sheet indicators.[3]

EARNINGS

During the 1960's Class I railroad net operating revenue, determined by revenues and expenses, rose from $1.9 billion in 1960, peaked at $2.5 billion in 1966, fell sharply in 1967, and then climbed slowly to $2.3 billion by the end of the decade. Total operating revenues, mostly from freight, increased almost every year from the preceding year, with a gain of almost $2.5 billion taking place between 1960 and 1970. Meanwhile operating expenses also increased, but by only a slightly larger amount. The operating ratio, which was 79.52 in 1960 was up to only 80.56 by 1970. On the whole, therefore, if the railroads were to be gauged solely by their net operating revenue, no significant change would appear to have taken place during the 1960–1970 period.

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[3] See Appendix, Tables A–3 through A–5 for comprehensive Income Statement, Financial Summary, and Selected Financial Ratios.

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Table 11, however, reveals considerable change during the decade, among individual roads and regions as well as for the railroads as a group. The overall rail operating ratio fell almost steadily through 1966, then rose in 1967, remained relatively constant in the following two years, and then climbed again in 1970. The pattern for the regions and the identified railroads followed roughly this same pattern, but there are both differences in the timing of particular movements as well as in the level achieved. The operating ratio in the East has remained above that for the Nation while that for the South has held consistently below the national average since 1964. In the West the ratio has been generally slightly below the national ratio although beginning in 1968 the West has done considerably better. As among individual roads, all of those identified except the Penn Central have performed better than the national average. For the Penn Central the operating ratio had increased steeply since 1966, up from approximately 79 in 1966 (based on premerger pro forma results) to 92 in 1970.

TABLE 11.—OPERATING RATIO,[1] CLASS I RAILROADS AND SELECTED RAILROADS, 1960–70

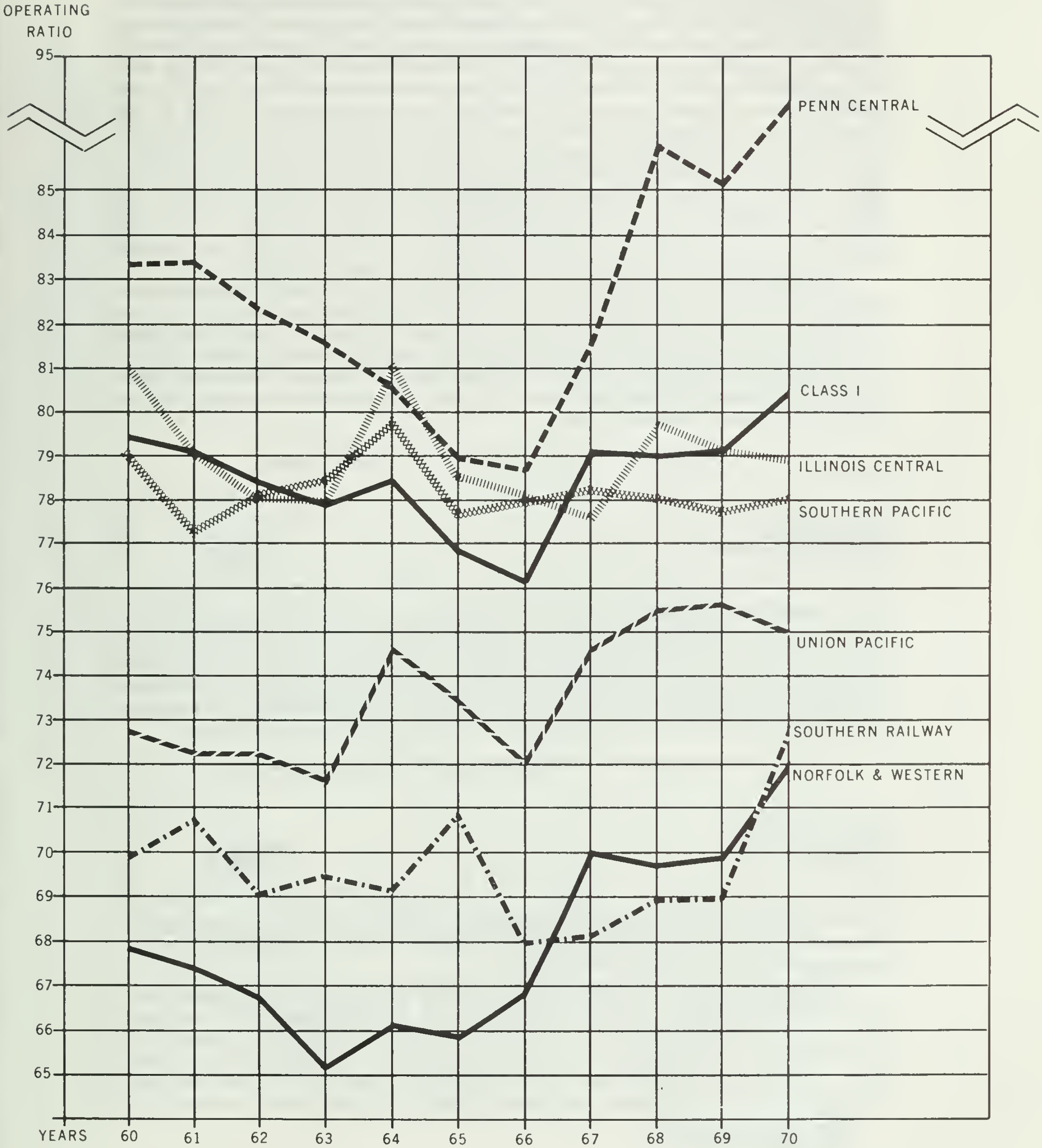
	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroads	79.52	79.16	78.59	77.95	78.50	76.90	76.19	79.15	79.05	79.18	80.56
Penn Central[2]	83.40	83.46	82.47	81.61	80.66	79.00	78.78	81.69	88.62	85.60	92.08
Pennsylvania	82.81	81.92	81.41	80.57	79.89	78.39	78.06	80.45			
New York Central	84.15	85.52	83.92	83.03	81.70	79.83	79.75	83.39			
Norfolk & Western[3]	67.97	67.47	66.80	65.52	66.47	65.95	66.90	70.04	69.74	69.95	72.02
New York Chicago & St. Louis	71.65	75.06	76.57	74.33	75.28						
Southern Railway	69.96	70.82	69.14	69.53	69.19	70.89	68.03	68.41	69.95	69.95	72.84
Illinois Central	81.14	79.12	78.16	78.09	81.17	78.69	78.19	77.67	79.84	79.21	78.99
Southern Pacific	79.11	77.38	78.18	78.53	79.92	77.80	78.03	87.34	78.13	77.85	78.17
Union Pacific	72.79	72.30	72.28	71.69	74.69	73.51	72.14	74.73	75.63	75.68	75.08

[1] Operating expenses per operating revenues.
[2] 1960–67 pro forma.
[3] 1960–64 pro forma.

Source: Moody's Transportation Manual.

CHART 2

OPERATING RATIO, CLASS I RAILROADS AND SELECTED LINES, 1960-1970



In explaining the differences in operating results among the various regions and roads, the answers naturally are to be found in the balance of revenue and expenses. In terms of revenue the East lags behind the nation, a point that further confirms the evidence advanced earlier concerning the changing nature of the economy. With 1960 as an index, the operating revenue of the Eastern roads stood at only about 115 per cent of the base, while the railroads nationally had increased their revenue by more than 25 per cent.[4] This discrepancy is primarily explained by the more rapid rates of growth in the West and particularly in the South. On the expense side operational outlays can generally be expected to parallel changes in revenue and traffic, but the net revenue impact of even small differences can be substantial. By 1970 the operating expenses of the Eastern roads were 120 per cent above the 1960 average; much of this was due to the Penn Central, whose expenses had increased by 23 per cent over the base period.[5] Generally speaking, those roads that did well during the 1960's, like the Southern Pacific and Union Pacific, were keeping their revenue and expense flows more nearly in balance. By 1970, for example, the SP's operating ratio was below what it had been in 1960.

Although there was some deterioration in the railroad operating ratio during the 1960's, it was not because of operational reasons that the railroads sustained such a steep drop in their net income. Indeed it is in the sources of the differences between *net operating revenue* and *net ordinary income* that are to be found the principal adverse developments of the decade. The dollar differences and changes in these basic earnings measures are indeed striking and can be quickly summarized as follows:

CHANGE IN SELECTED INCOME ACCOUNTS, 1960–70, CLASS I RAILROADS

	Amount	Percent
Net operating revenue	+$382,000,000	+19.7
Net railroad operating income	−100,000,000	−16.9
Ordinary income	−218,000,000	−49.0

The substantial differences noted in this table between net operating revenue, which was up significantly, and the subsequent items, down substantially, are determined by a combination of factors, notably rents paid for the hire of equipment, fixed charges, and "other income." Of these the former two increased steeply and while the latter also rose, it fell far short of offsetting the two other sources of cash outflow. The changes in these items can be summed up:

CHANGE IN MAJOR ITEMS AFFECTING ORDINARY INCOME, 1960–70, CLASS I RAILROADS

	Amount	Percent
Rents for equipment hire	+$415,000,000	+129.0
Fixed charges	+216,000,000	+58.1
Other income	+136,000,000	+39.3

Other items also changed during the period. Railway tax accruals, for example, increased by about $70 million, but their impact on earnings was small relative to the items noted in the preceding table.

To gain a better impression of the impact of increased equipment rentals on railroad earnings, Table 12 shows that as a percentage of net operating revenue these rental payments held almost constant from 1960 through 1966, remaining on an approximate 20 per cent plateau. In 1967, however, rentals rose steeply and by 1970 they were absorbing a third of rail net operating revenue. Not all the regions and roads, though, followed this pattern.[6] In the

[4] See Appendix, Table A–6.
[5] See Appendix, Table A–7.
[6] See Appendix, Table A–8.

East rentals were far more significant, largely because of the Penn Central. By 1970 equipment rents in fact exceeded the PC net operating revenue. In other geographic areas the pattern fairly closely followed that for the nation, with equipment rentals taking a larger share of operating revenue after 1966 but with the percentage remaining considerably below that for the nation. For some individual roads, such as the Southern and Union Pacific, rents for equipment continue to consume only a small percentage of operating revenue.

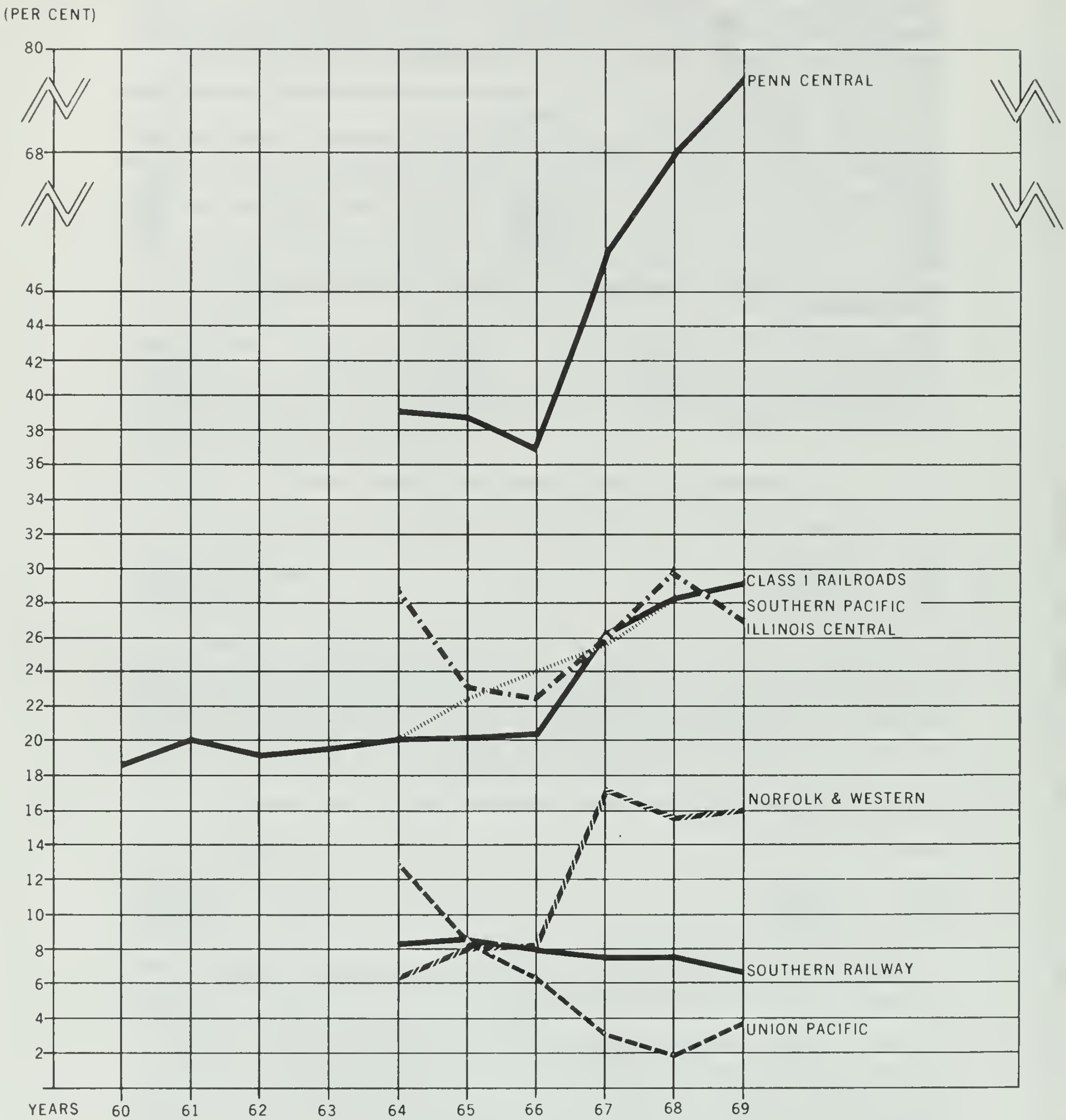
TABLE 12.—EQUIPMENT AND JOINT FACILITIES RENTS AS A PERCENT OF NET OPERATING REVENUE, CLASS I RAILROADS 1960–70

Year	Percent	Year	Percent
1960	18.8	1966	20.6
1961	20.2	1967	26.6
1962	19.3	1968	28.6
1963	19.7	1969	29.4
1964	20.3	1970	33.3
1965	20.4		

Source: ICC and AAR.

CHART 3

EQUIPMENT AND FACILITIES RENTS AS A PER CENT OF NET OPERATING REVENUE, CLASS I RAILROADS AND SELECTED LINES, 1960-1969



In terms of fixed charges the major portion of the increases is in interest on funded debt. This subcategory alone generated increased expenditures of $184 million, equal to about 85 per cent of the gain in fixed charges that took place between 1960 and 1970. What caused this expense category to increase so markedly was a combination of two elements, increased debt outstanding and rising interest rates. In 1960 the railroads had outstanding $2.7 billion in equipment obligations, with new issues that year of $323 million at an average interest rate of 4.65 per cent. By the end of 1968 equipment obligations exceeded $4.2 billion and in the three years 1966 through 1968 railroads issued about $2.5 billion in new equipment obligations, at an average annual interest rate of almost six per cent. These large additional issues, along with climbing interest rates, combined to increase fixed charges, which have come to absorb a growing proportion of net railway operating income. From 1961 through 1966 the share of net railway operating income taken by fixed charges fell from nearly 70 per cent to about 40 per cent. In contrast by 1969 fixed charges amounted to almost 80 per cent of net railway operating income and by 1970 they had climbed above the 100 per cent level.[7]

As can be seen in Table 13 there are radical differences among regions and individual companies. The Penn Central is once more the primary statistical culprit, pushing the average above 100 per cent even though for other roads the share of net railway operating income accounted for by fixed charges is far less. Among the other railroads identified in the table the N&W, Southern, and Union Pacific were paying out less than half of their net railway operating income (NROI) in fixed charges in 1970.

TABLE 13.—ANNUAL FIXED CHARGES AS A PERCENT OF NET RAILWAY OPERATING INCOME, REGIONAL DISTRICTS AND SELECTED RAILROADS, 1964-70

	1964	1965	1966	1967	1968	1969	1970
Eastern district	56.4	58.6	55.9	(1)	(1)	(1)	(2)
Penn Central [3]	(1)	81.8	69.7	(1)	(2)	(2)	(2)
Pennsylvania	(1)	92.6	79.1	(1)			
New York Central	(1)	72.0	60.3	(1)			
Norfolk & Western [4]	28.0	26.9	29.8	38.8	41.3	40.7	40.2
Southern district	67.6	41.6	40.3	48.8	51.6	49.6	50.6
Southern Railway	31.0	36.7	35.2	34.6	39.3	38.9	41.3
Illinois Central	36.6	29.1	28.2	36.4	63.2	51.1	61.5
Western district	31.4	28.4	28.6	45.5	42.8	47.4	51.1
Southern Pacific	45.5	41.9	48.5	60.2	48.5	48.2	59.4
Union Pacific	6.9	5.2	6.6	12.5	13.8	14.2	22.8

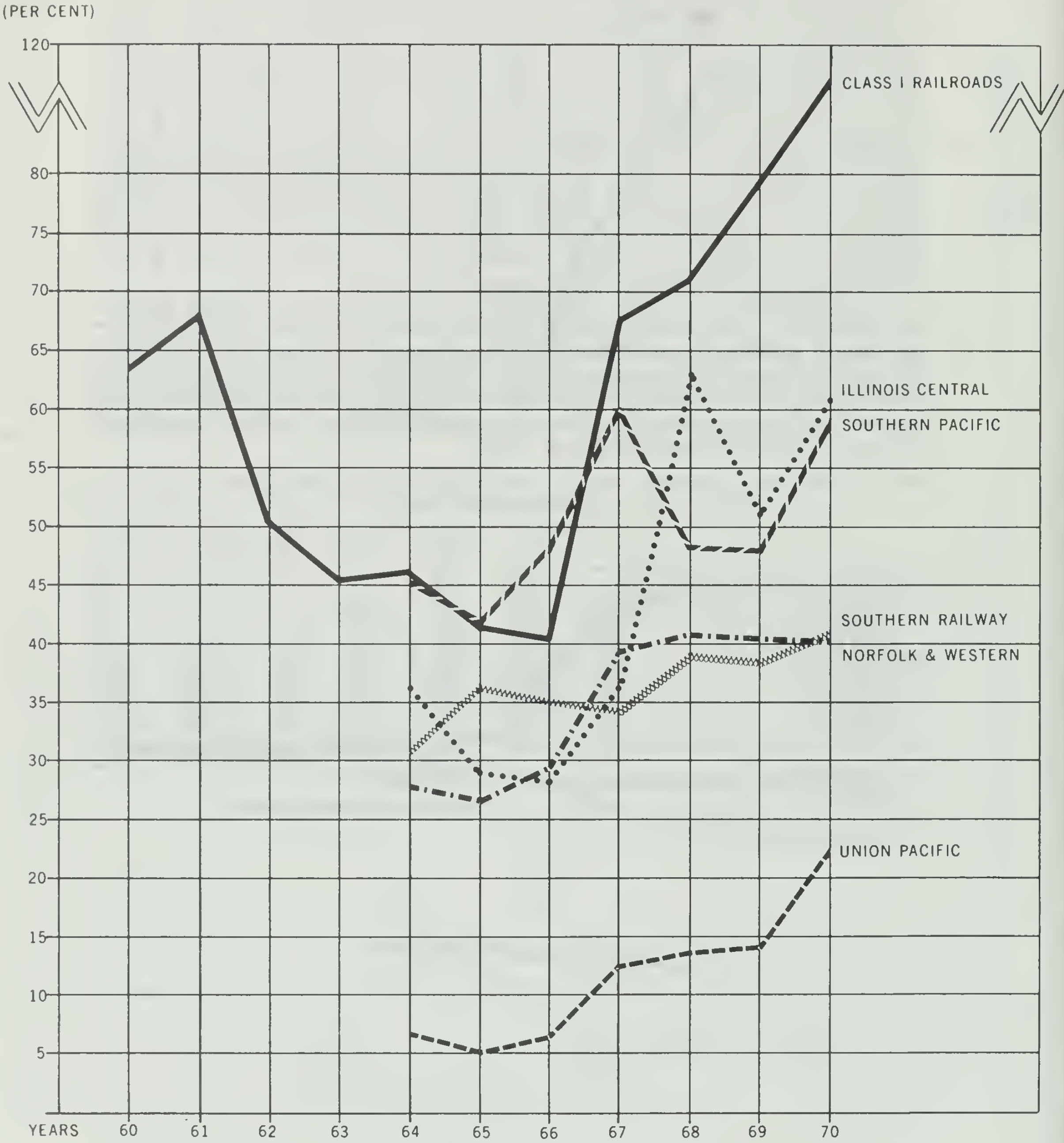
[1] Over 100 percent.
[2] Not calculated because net railway operating income is a debit amount.
[3] 1964-67 pro forma.
[4] 1964 pro forma.

Source: Moody's Transportation Manual.

[7] See Appendix, Table A-9.

CHART 4

ANNUAL FIXED CHARGES AS A PER CENT OF NET RAILWAY OPERATING INCOME, CLASS I RAILROADS AND SELECTED LINES, 1960-1970



CAPITAL OUTLAYS, OVERT AND DISGUISED

Although the degree of change varied considerably among the individual roads and geographic regions, increases took place generally in the industry in the relative significance of fixed charges and equipment rents after 1966. Explaining this was a high level of gross capital investment that began to exceed cash flow by a considerable margin beginning in about 1964. Before that cash flow was greater than the amount of annual capital outlays, which meant that the railroads did not need to increase their external borrowings. From 1960 through 1963 outstanding equipment obligations actually fell and by 1963 they were just about the same as in 1955 despite an overall expansion in rail revenues.

However, in 1964 gross capital expenditures, rising steeply, climbed above cash flow, forcing the railroads as a group to enter the market in search of capital. They did this in two ways, with each being reflected in the growth of fixed charges and equipment rents. From a level of outstanding equipment obligations of $2.6 billion in 1963, the railroads increased this predominant form of debt at a rate of almost $300 million a year over the next five years. With interest rates escalating, the combined effect of increased borrowings and rising interest rates raised fixed charges by almost $200 million between 1964 and 1970, with the bulk of this represented in interest on funded debt. (The railroads also stepped up their short-term borrowings, including commercial paper; interest on unfunded debt increased from $2 million in 1965 to more than $25 million in 1970.)

The second source of capital outlays, disguised in character, took the form of equipment leasing with the rents being an alternative to interest. Rents for the hire of equipment, mostly rolling stock, rose steeply after 1964. Not all railroads employed this technique (the Southern and the UP are two important exceptions), but most railroads did so, with the Penn Central being the most striking case. Total rents paid by the railroads rose from $392 million in 1964 to $736 million in 1970. This increase of more than $340 million took place at a time when pre-tax operating revenue was up only about $200 million.

Because of their growing absolute and relative significance, it is well to look closely at railroad equipment rentals. First, most of the equipment which was rented came from non-rail investors. By leasing equipment rather than lending capital their security was enhanced without losing the benefit of depreciation and the Investment Tax Credit, which had taken effect with taxable years ending after December 31, 1961. For these reasons equipment leasing became common in the railroad industry during the middle-1960's, just as it did in many other areas of the economy (e.g., air transportation). Second, a significant amount of equipment leasing has involved railroad-affiliated firms, and sometimes those under railroad control (directly or through a controlling holding company). The exact extent of intra-family leasing is unknown, but Commission investigation has shown that at least one railroad made extensive use of such rental arrangements. The railroad in point is the Kansas City Southern, which set up a subsidiary known as Carland, Inc., to lease various types of equipment to the railroad. According to the Commission the terms of the leases were disadvantageous to the railroad, calling for the carrier to pay considerably more than if the property were owned and requiring the advance of capital for the initial purchase.

With both interest and rentals rising steeply in the latter half of the 1960's, railroad earnings declined markedly. "Other income," which does not include all non-rail earnings, helped ease the problem somewhat, representing an increasing percentage of pre-tax net income after 1966.[8] For the Western roads this reflected more the increase in revenues from other sources while in the East it reflected more the sharp decline in earnings from railroad operations. Despite the increase in other income, up by over $100 million between 1965 and 1970, the effect of rising fixed charges and equipment rentals was so great that it produced a sharp fall during that same period in net income. It deserves reemphasis, though, to note that more than 68 per cent of the decline in net earnings comes from the Penn Central alone.

[8] See Appendix, Tables A–10 and A–11, for share of pre-Federal Income Tax Ordinary Income represented by Other Income.

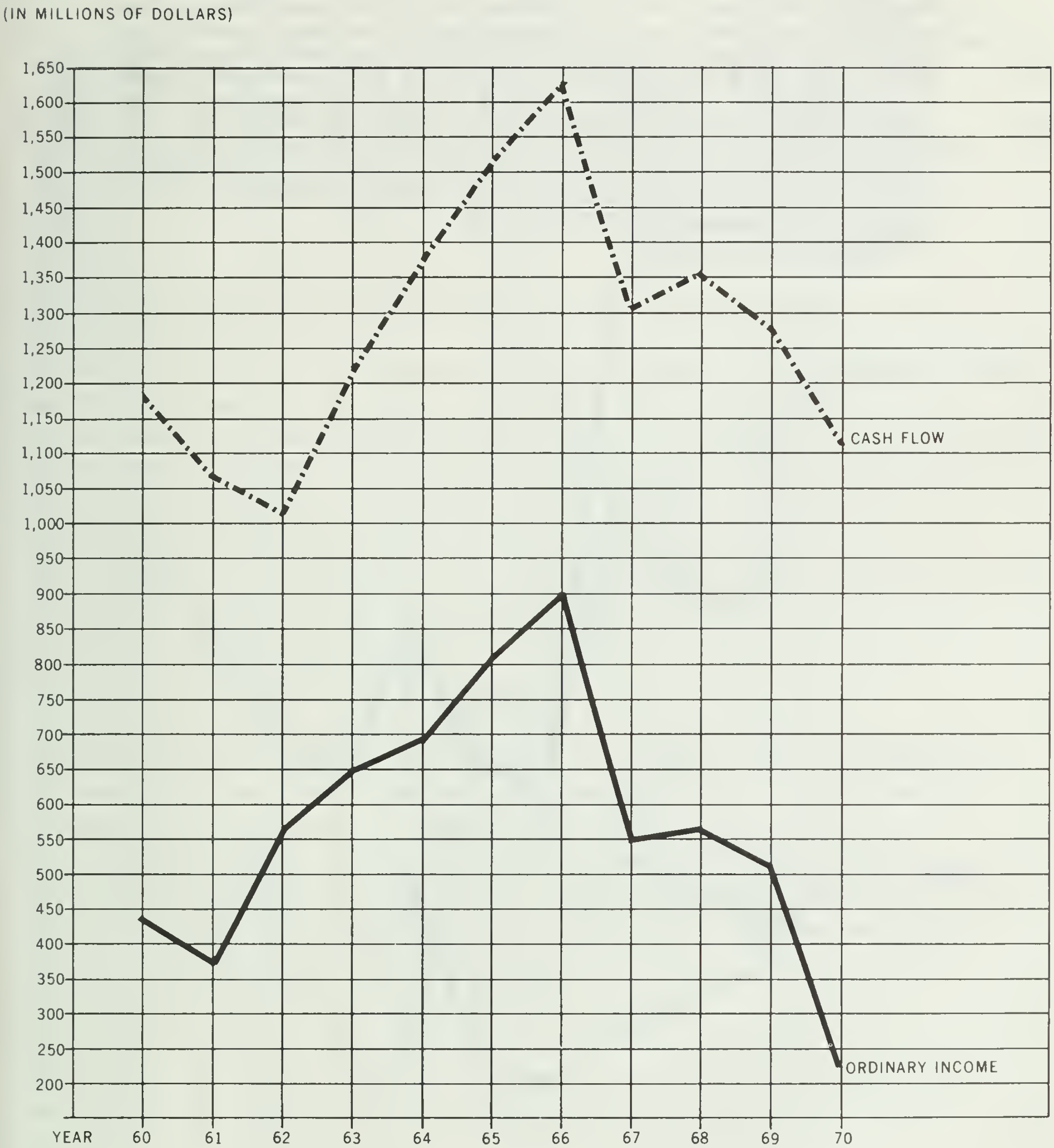
CASH FLOW

In the late 1960's the railroads, to a varying degree, clearly sustained considerable deterioration in their earnings. The fall in cash flow, however, was far less pronounced. In 1970, for example, Class I railroad cash flow, although down about 33 per cent from 1965, was still in excess of $1 billion.[9] By comparison, net income in that same period fell by close to 70 per cent.[10] Since earnings involve many non-cash bookkeeping entries, cash flow is a better criterion by which to judge basic industry health. By this test the railroad position, though in decline after about 1966, is neither so pronounced nor dangerous as those who spotlight earnings figures might like to suggest. Moreover, the Penn Central so badly distorts the industry's earnings picture as to render it alone a highly suspect basis for financial evaluation.

[9] Appendix, Table A–12.
[10] For comparison of Ordinary Income and Cash Flow, see Appendix, Table A–13. Tables A–14 and A–15 relate Cash Flow with Fixed Charges and Net Worth, respectively.

CHART 5

ORDINARY INCOME AND CASH FLOW, CLASS I RAILROADS, 1960-1970

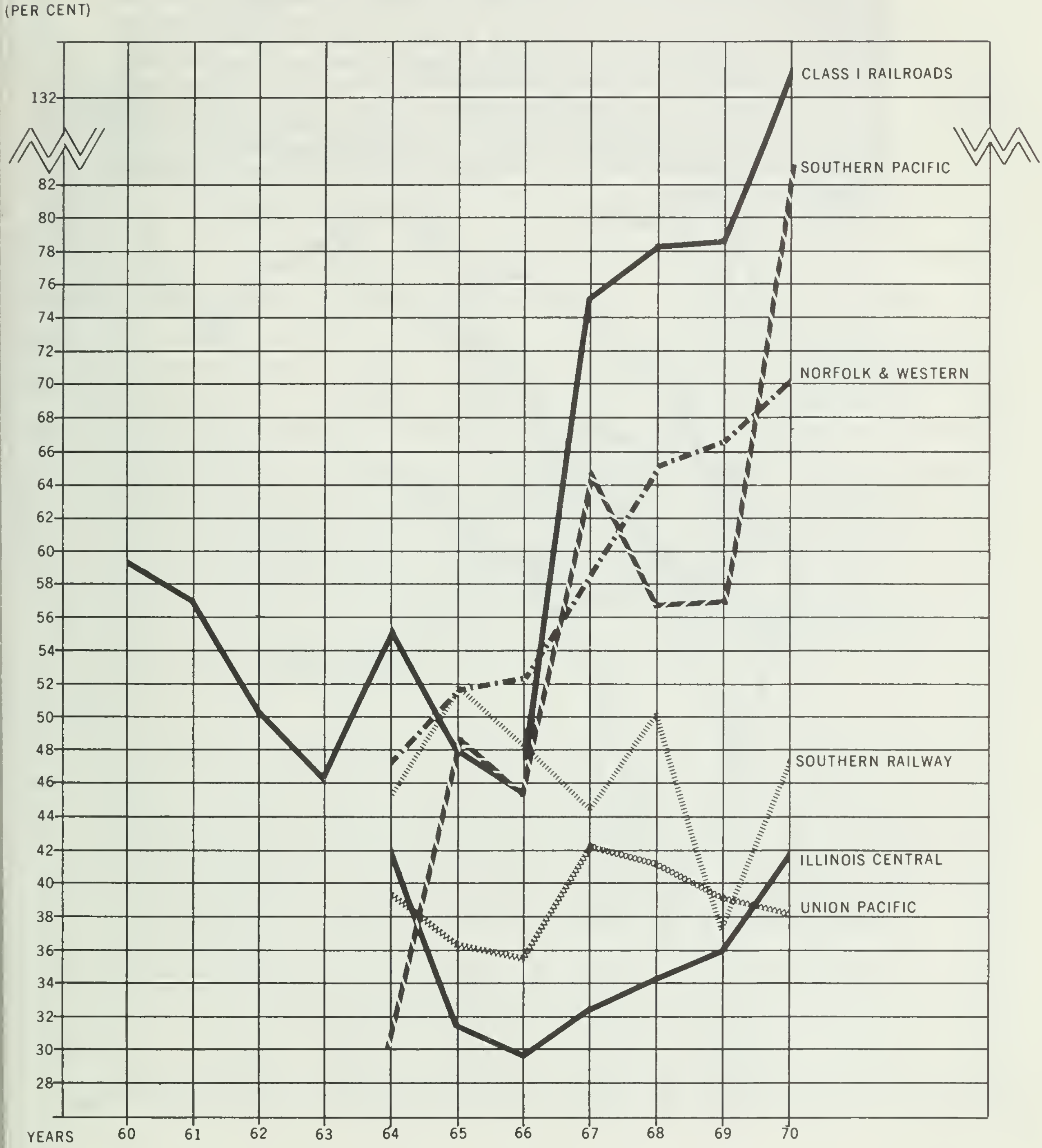


Despite the decline in earnings and cash flow, with the former much larger than the latter, the railroads continued to pay substantial cash dividends in the late 1960's. By 1970 cash dividends exceeded net income and consumed more than 40 per cent of cash flow. [11] In some instances this practice might arguably be understandable. For example, if the railroads were raising significant amounts of capital through new equity issues, it might be that dividends were essential to attract and maintain investment interest. The fact, however, is that new public equity issues are highly insignificant in the railroad industry, providing only a miniscule amount of funds. The explanation for the perpetuation of large cash dividend payments in the face of falling earnings thus must be found elsewhere. Conceivably, it reflects intercorporate relationships, with dividends being a means by which a holding company or affiliated firm withdraws cash from the railroad. Aside from this explanation, which is of growing consequence because of the spread of holding companies in rail transportation, there is no apparent explanation for the large cash dividends which have been paid under recent railroad circumstances.

[11] Appendix, Tables A–16 and A–17.

CHART 6

CASH DIVIDENDS AS A PER CENT OF PRE-FEDERAL INCOME TAX ORDINARY INCOME, CLASS I RAILROADS AND SELECTED LINES, 1960-1970



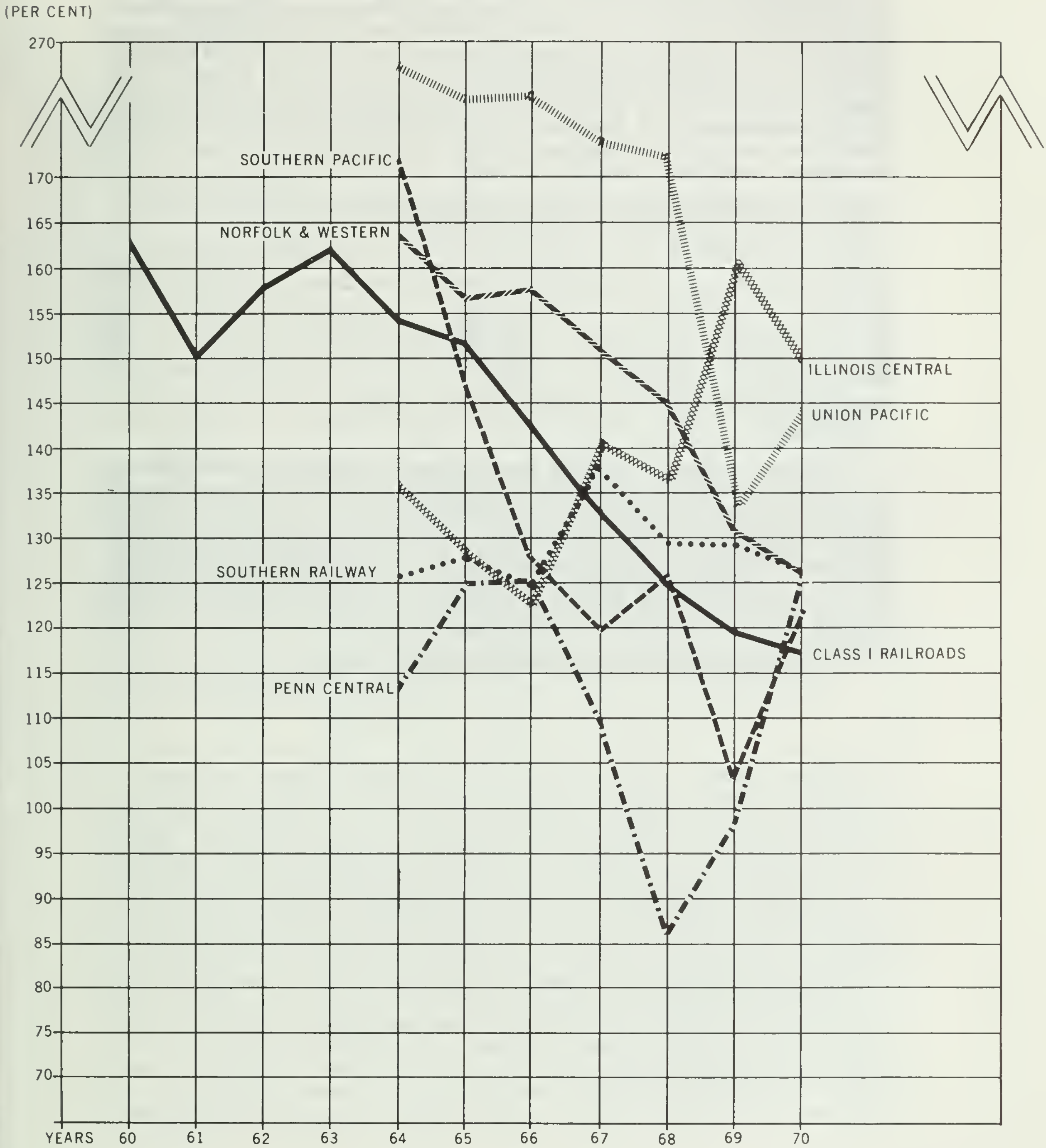
WORKING CAPITAL

The consolidated financial impact of all the preceding forces has been to reduce net working capital of the Class I railroads by more than $500 million since 1965. Current assets as a percentage of current liabilities have fallen from an average of more than 150 per cent in the first half of the 1960's to less than 125 per cent in 1970.[12] Since there is no acceptable measure for the desirable current ratio, this shrinkage in the margin of current assets over current liabilities cannot necessarily be judged as bad. Indeed, some of the stronger roads have maintained for some time only a small working capital margin. In addition, corporations generally have reduced their working capital margins in the last ten years. Between 1961 and 1969 U.S. corporations cut back the margin by almost 20 per cent reflecting, in part, greater efficiency in the management of short-term balances.

[12] Appendix, Tables A-18 and A-19.

CHART 7

CURRENT ASSETS AS A PER CENT OF CURRENT LIABILITIES, CLASS I RAILROADS AND SELECTED LINES, 1960-1970



Where the financial situation is somewhat more troublesome is in the proportion of debt due within one year, which increased to more than $600 million at the end of 1970 (Table 14).[13] This amounted to about six times net working capital. On the face of it this would appear to be a highly dangerous condition, but the severity of the problem cannot be so easily gauged. For one thing, there were improvements between 1969 and 1970, with the debt due within one year/net working capital ratio being reduced from about 13 times to 4 times. Moreover, virtually all short-term debt is rolled over, so that except for railroads in grave condition, like the Penn Central was in just prior to its bankruptcy, the presence of a large amount of overhanging near-term debt is not nearly so awesome as is sometimes thought. What may be more significant is that short-term debt is usually more costly.

TABLE 14.—DEBT DUE WITHIN 1 YEAR AS A PERCENT OF PRE-FEDERAL INCOME TAX ORDINARY INCOME,[1] CLASS I RAILROADS, 1960–70

Year	Percent	Year	Percent
1960	69.8	1966	48.6
1961	63.1	1967	84.6
1962	58.5	1968	93.7
1963	55.4	1969	(2)
1964	54.3	1970	(2)
1965	47.4		

[1] Before 1967 reported as net income.
[2] Over 100 percent.

Source: ICC and AAR.

As one looks back through the facts reviewed in this section, it is clear that investment—its amount, character, and inferentially its utilization—plays a dominant role in explaining the financial fate of the rail industry. As noted earlier it is fixed charges (representing primarily payments on loans made to purchase rolling stock) and equipment rentals (a disguised form of investment) that have contributed so greatly to the decline in railroad ordinary income during the latter part of the 1960's. Because investment is thus so important the next section is devoted to its assessment.

[13] Similar data for selected railroads are reported in Appendix, Table A–20.

INVESTMENT AND PRODUCTIVITY

As an industry rail transportation is one of the most capital-intensive in the economy. At the end of 1970 total investment in railroad property used in transportation amounted to $37.5 billion. After deducting accrued depreciation and amortization of over $10 billion, average net investment came to more than $28 billion. The latter figure is only $600 million more than in 1960, but this masks the fact that between 1960 and 1970 the railroads reported more than $14 billion in gross capital expenditures. The industry has an enormous appetite for capital, one that is fed by its low rate of capital turnover. With net investment of more than $28 billion and total operating revenues of about $12 billion, the ratio of revenue to assets remains low by comparison with other industries despite some improvement over the last decade. Because of its large capital requirements railroad economic health depends heavily on the way in which assets are used and how they are financed. The ability of the industry to increase its utilization of capital by even a very small amount can mean a large difference in earnings because of the impact on debt and fixed charges. For example, if freight car use were to improve at an annual rate of 3.5 per cent over the next ten years instead of 1.5 per cent, railroad capital needs could be reduced by as much as $18 billion. Equally important, more intensive use of capital investment would mean better service to shippers and attract additional traffic. To a very great extent, therefore, the question of capital management is the key to the problems of the railroad industry.

Investment statistics in recent years clearly demonstrate one fact: the railroads are able to raise large amounts of capital. It is often pointed out that the earnings of the railroad industry, as a percentage of net worth, are low by comparison with other sectors. Class I railroad earnings amounted to only about three per cent on net worth in 1970, only a fourth of the rate of return in manufacturing and a third of the rate of return in all industries. If this were the appropriate investment yardstick, the railroads would obviously be unable to attract any external funds since a three per cent rate of return is below even the prime interest rate. What is also true is that both the railroads and their investors realize that for some, new, incremental investment returns are actually considerably higher. On an intensively used freight car, for example, the anticipated discounted return may be as high as 20 per cent.

THE CHARACTER OF RAIL INVESTMENT

Railroad capital requirements are highly diverse and the investment circumstances are equally varied, meaning that it is much easier to raise funds for some purposes than for others and that the pattern of investment can be skewed. This is attributable in part to the fact that while investments are typically made by individual railroads, the benefits are shared by the entire railroad system. This is exemplified by freight cars, which account for the bulk of new railroad investment. Since at any given time a substantial percentage of a railroad's freight cars will be in use on other lines and since a typical shipment moves on more than two lines, the benefits of such rolling stock investment are shared within the system. So long as some returns can be derived from the capital outlay which is made, as is true with per diem payments for freight cars, the system characteristics may not inhibit carrier investments. However, where this is not feasible, a railroad may hesitate or refrain from investing in certain types of capital. For example, any one carrier may not be willing to invest in a costly electronic system for freight car management if the benefits can be realized only if other railroads also make similar investments.

In considering the nature of railroad investment, there are other factors to be taken into account. From the standpoint of legal security for lenders, it is often much easier to obtain funds for some types of investment than others. A locomotive or freight car is portable and in the event of default on required payments, rolling stock can be transferred to another railroad. This is not the case with investment in track, terminals and yards, or even in computer or telecommunication facilities. (Conceivably they may even be covered by after-acquired clauses in existing mortgages or covenants.) While such fixed investments might add greatly to railroad operating efficiency, they tend to be under-financed except for railroads which can generate the necessary capital internally.

Since 1964 the railroads have recorded gross capital expenditures of well over $1 billion a year. Between 1965 and 1970 their gross capital expenditures amounted to $9.2 billion (Table 15). Of this about three-fourths was for equipment. As noted elsewhere, additional capital investment was made in railroad property by non-railroad interests and either leased to the railroads or to special users. Precise numbers are unavailable, but some indication can be gained from the fact that private car companies and shippers (including firms such as the Trailer Train Company which are owned by the railroads) added more than 55,000 cars to their fleets between 1960 and 1970 (meanwhile, cars owned or leased by the Class I railroads declined by about 240,000). Although the number of freight cars in railroad service was nearly 200,000 fewer in 1970 than 1960, total freight car capacity increased somewhat, because of the substitution of bigger for smaller cars.

TABLE 15.—GROSS CAPITAL EXPENDITURES AND CASH FLOW, CLASS I RAILROADS, 1960–70

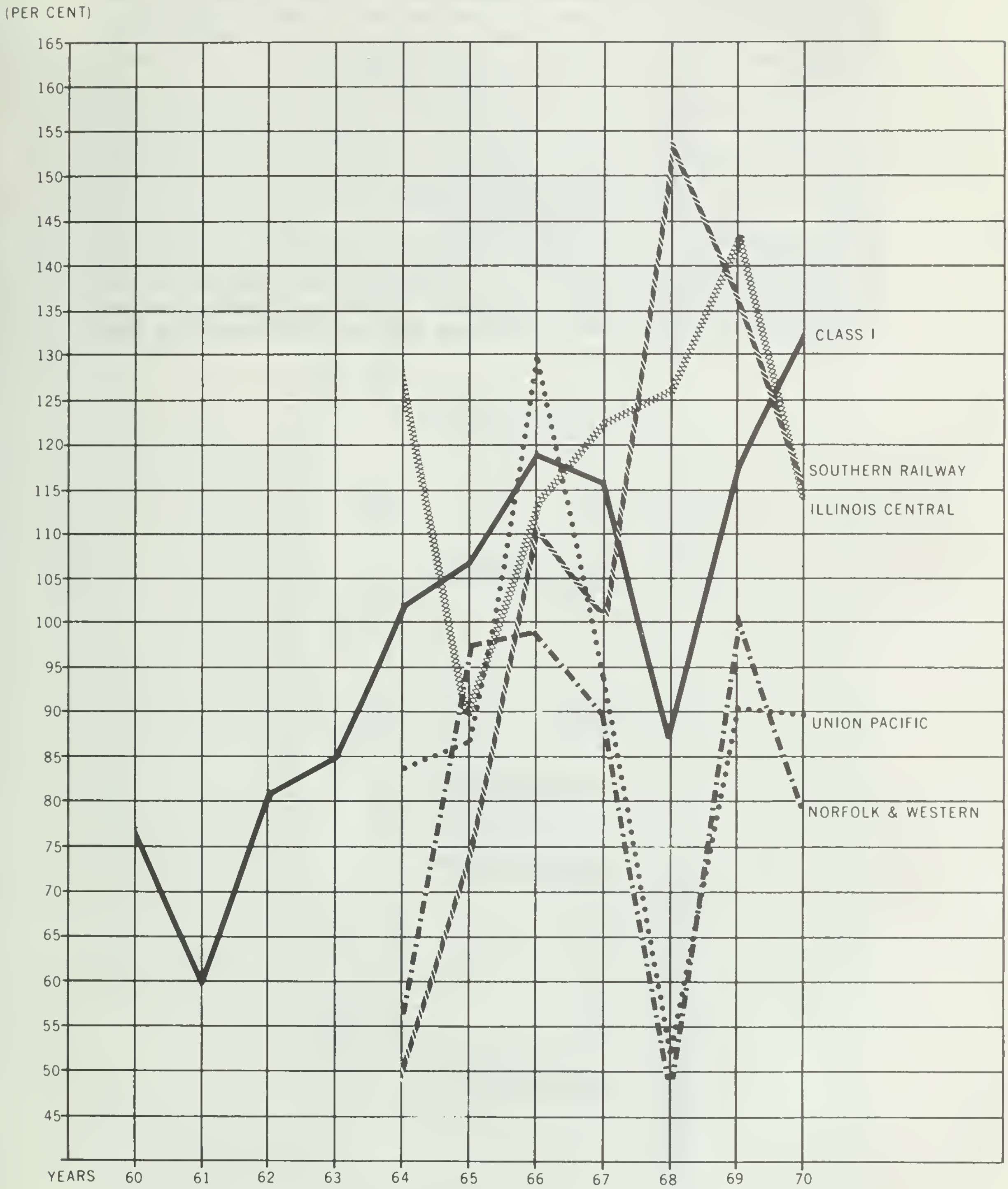
[In thousands of dollars]

Year:	Gross capital expenditures			Cash flow	Gross capital expenditures as a percent of cash flow
	Total	Equipment	Roadway and structure		
1960	919,154	633,490	285,664	1,191,693	77.1
1961	646,425	427,130	219,295	1,073,155	60.2
1962	832,938	593,369	239,569	1,023,229	81.4
1963	1,043,788	784,874	258,914	1,226,326	85.1
1964	1,417,263	1,139,683	277,580	1,383,824	102.4
1965	1,630,686	1,303,602	327,084	1,521,210	107.2
1966	1,952,804	1,554,223	398,581	1,634,349	119.5
1967	1,522,478	1,148,381	374,097	1,310,092	116.2
1968	1,186,979	818,720	368,259	1,363,132	87.1
1909	1,509,393	1,088,712	420,681	1,280,043	117.9
1970	1,350,120	993,095	357,025	1,016,177	132.9

Source: ICC, AAR and Moody's Transportation Manual.

CHART 8

GROSS CAPITAL EXPENDITURES AS A PER CENT OF CASH FLOW, CLASS I RAILROADS AND SELECTED LINES, 1960-1970



The character of freight car investment during the last decade has resulted in a fleet that in 1970 was quite different from what it was at the beginning of the period. First, a growing proportion of freight cars in railroad service are owned, not by the railroads, but by car companies and shippers. Of the cars in the railroad fleet in 1960, 14 per cent were owned by car companies and shippers; by 1970 this share had increased to 19 per cent. One of every five freight cars is thus now owned by a non-railroad organization. Closely related to this development is the growing insistence by major shippers that railroads commit or dedicate a certain number of cars to their requirements.

Second, the freight car fleet is becoming increasingly specialized by function (Table 16). The number of unequipped box cars has fallen sharply, but the number of equipped box cars, special service flat cars, and covered hopper cars has increased. The general impression, therefore, is that the rail freight car fleet has been more closely tailored to special purposes, reflecting the particular requirements of the approximately 100 or so big shippers who account for an estimated 75 per cent or more of rail traffic. Among other implications this trend means that the railroads are increasingly less flexible in their ability to meet seasonal requirements and the demands of the many small and medium-size shippers. It also helps explain why empty freight car miles have increased, as cars are routed empty rather than being used for a different return load.

TABLE 16.—NEW FREIGHT CARS INSTALLED, CLASS I RAILROADS, 1955–70

Year ending	Boxcar				Flatcar					Gondola car			Hopper car				
	General service												Open top				
	Total [1]	Un-equipped	Equipped	Special service	General service [2]	Special service	TOFC	Rack car	Auto-mobile rack car	Total	General service	Special service	Total [3]	General service	Special service	Covered	Total freight cars
1955	16,754			1,013	890			442		1,690			3,619			3,086	28,837
1956	26,325			2,181	2,650			813		4,486			13,576			4,557	55,442
1957	29,968			2,164	823			2,488		9,786			29,925			6,528	82,299
1958	8,240			521	601			235		10,512			9,890			3,522	33,976
1959	10,285			881	1,484			341		343			8,076			3,283	42,288
1960	12,566			2,184	2,101			669		7,345			21,973			2,603	53,764
1961	7,256			929	1,525			346		2,573			8,555			2,107	26,050
1962	5,862			2,942	1,368			582		664			10,075			3,760	29,125
1963	6,582			5,286	2,580			1,385		347			7,065			4,463	32,972
1964	6,800			6,484	1,529			2,925		1,349			19,305			8,107	51,928
1965	7,045			13,822	1,222	1,800		2,863		5,341			12,062			10,961	62,692
1966	9,731			17,342	936	1,877		3,909		5,481			14,127			14,183	75,057
1967	9,612			12,927	441	816		4,965		8,106			12,040			16,144	70,096
1968	NA	6,546	9,193	1,239	651	2,478	475	NA	607	NA	7,779	1,095	NA	10,966	335	4,463	46,810
1969	NA				NA	NA	NA	NA	NA	NA			NA			NA	53,200
1970	NA				NA	NA	NA	NA	NA	NA			NA			NA	56,031

[1] Includes unequipped and equipped general -service boxcars prior to 1968.
[2] Includes special-service flatcars prior to 1965 and TOFC and automobile rack cars prior to 1968.
[3] Includes general- and special-service gondola cars and open-top hopper cars prior to 1968.

Source: ICC and AAR.

ADEQUACY OF INVESTMENT

Little can be said about the adequacy of the investment in roadway, structures, and other non-rolling stock items. It is often said, for example, that railroad replacement of cross ties and rail has not been sufficient to replace existing installations; but this would be true only if all rail and all cross ties had to be replaced at the same rate and on the same schedule. On some little-used track no replacement at all may be called for; secondary tracks similarly require less frequent upgrading than main lines. Currently the railroads are replacing about 17 million cross ties a year and installing over 2,000 miles of new rail (Table 17). What is not known is how these replacements and installations are being allocated among track types and uses. New rail and cross tie installations are presently running at a rate below that experienced in the early 1950's. However, the average weight per yard of rail has been increased; by the end of 1969 more than 63,000 miles of track had rails averaging more than 130 pounds per yard. This is up 10,000 miles since 1960 and almost 9,000 miles since 1965. In addition, more than 40,000 miles of road are now under centralized traffic control; this is up by a third since 1960. These facts represent major improvements in the physical plant, but whether they are adequate would require far more disaggregated information about patterns of use than is now available.

TABLE 17.—MILES OF NEW RAIL LAID, NUMBER OF TIES REPLACED AND MILES OF CENTRALIZED TRAFFIC CONTROL, CLASS I RAILROADS, 1960–70

Year	Miles of new rail laid	Number of ties replaced (thousands)	Miles of centralized traffic control	Year	Miles of new rail laid	Number of ties replaced (thousands)	Miles of centralized traffic control
1960	1,285	14,237	35,997	1966	2,363	15,250	44,258
1961	1,364	11,970	(1)	1967	1,912	15,022	45,400
1962	1,802	13,375	(1)	1968	2,292	17,044	46,598
1963	1,669	13,601	(1)	1969	(1)	17,323	47,097
1964	1,882	13,524	(1)	1970	(1)	(1)	47,900
1965	1,885	14,714	44,025				

[1] Not available.

Source: ICC, AAR, Department of Transportation and Moody's Transportation Manual.

If there are inadequacies in railroad non-rolling stock investment, they are likely to be related to those elements that have a so-called systems effect. This relates to the point made earlier, namely that certain individual railroad investments may be worthwhile only if other railroads make similar commitments. The best example concerns national freight car utilization. Recognizing the need for a nation-wide approach to this problem, the Association of American Railroads set up a computer system called TRAIN. It calls for member Class I railroads to transmit information about their car movements, notably at interchange points. Its potential is considerable, but its use to date has been limited largely because some carriers do not have sufficiently reliable interchange teleprocessing systems to provide the necessary timely information. While adoption of such a national system would be highly advantageous and permit the railroads to make more efficient use of their rail car fleet, the necessary capital commitment is large and the uncertainty that others would also do so has caused carriers to hesitate, thereby frustrating implementation of a potentially high payoff system.

PRODUCTIVITY

The relative scale and composition of railroad investment, though an important dimension of industry activity, necessarily offers an incomplete picture for it concentrates on only the input side of the equation. Ultimately, of course, investment must be tested by its payoff and this calls for an examination of the pertinent productivity data.[14] At issue here is whether and at what rate of change capital invested by the railroads is generating increasing returns per unit of investment. There is nothing peculiar to the railroads in this inquiry,

[14] The basic data for capital productivity are in Table 18.

for the question of productivity is fundamental to the growth of the economy and is a well-accepted test of relative industry health. Normally we would expect that over time both labor and capital will become more productive. The hour of work or the dollar of capital that yields 100 units of output one year might generate 105 units the next year, 110 the following year, and so forth. Increased productivity, of capital and labor, is indeed the chief determinant of the growth of the American economy. Conversely, in sectors where productivity is not rising, or where its rate of increase is below that for the economy as a whole, decline is inevitable.

TABLE 18.—CAPITAL PRODUCTIVITY, SELECTED MEASURES, CLASS I RAILROADS, 1960–70

Index, 1960=100

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Operating revenue per dollar of net investment	0.346	0.338	0.365	0.371	0.379	0.388	0.390	0.374	0.392	0.411	0.425
Index	100.0	97.7	105.5	107.2	109.5	112.1	112.7	108.1	113.3	118.8	122.8
Originated tonnage per dollar of net investment	.045	.044	.048	.050	.052	.053	.053	.051	.052	.053	.053
Index	100.0	97.8	106.8	111.1	115.5	117.8	117.8	113.3	115.5	117.8	117.8
Dollar of operating expenses per originated tonnage ($)	6.097	6.094	6.014	5.780	5.712	5.658	5.603	5.828	5.995	6.153	6.630
Index	100.0	99.6	98.6	94.8	93.7	92.8	91.9	95.6	98.3	100.9	108.7
Ton-miles per dollar of net investment	20.83	20.73	22.93	24.12	25.34	26.52	27.03	25.94	26.89	27.53	27.05
Index	100.0	100.0	110.1	115.8	121.7	127.3	129.8	124.5	129.1	132.2	129.9
Railway operating income per dollar of net investment	.035	.034	.043	.047	.048	.055	.057	.045	.048	.049	.045
Index	100.0	97.1	122.9	134.3	137.1	157.1	162.9	128.6	137.1	140.0	128.6
Net railway operating income per dollar of net investment	.021	.020	.028	.031	.031	.037	.038	.024	.025	.023	.017
Index	100.0	95.2	133.3	147.6	147.6	176.2	180.9	114.3	119.0	109.5	81.0
Income available for fixed charges per dollar of net investment	.032	.029	.038	.041	.043	.048	.050	.038	.039	.038	.030
Index	100.0	90.6	118.8	128.1	134.4	150.0	156.3	118.8	121.9	118.8	93.7

Source: ICC and AAR.

How to measure productivity? This has been a topic for extended debate among economists, with considerable argument (and little agreement) as to the appropriate indicia of both input and output. For immediate purposes several different standards can be employed, recognizing that each has some infirmity. As an example, the available output indicators—tons, ton-miles, operating revenue—are influenced by short-run fluctuations in the economic cycle, but inputs (number of workers, invested capital) do not change as readily. In short periods of time this imbalance can produce statistical aberrations and regardless of the statistical technique used this problem cannot be fully compensated for. Acknowledging the difficulties that are necessarily involved, we can define a few practical tests and apply them to the railroad situation. The objective is to determine whether the productivity of labor, on the one hand, and capital, on the other, has been increasing over the last ten years, at what rate, and in what pattern within the period.

Two sets of output criteria will be used: one will focus on physical measures (e.g., tons of freight transported), the other on financial measures (e.g., has there been an increasing earnings return on investment). A good starting point is the relationship between railroad traffic and railroad investment. As Table 18 shows, between 1960 and 1970 there was a modest gain—very small in fact—of 18 per cent in tonnage moved per dollar of investment. In terms of ton-miles there was a somewhat larger increase, of about 30 per cent. By either standard the improvement was quite small. Why? For one thing productivity gains in the use of freight cars, the biggest continuing source of industry investment, were modest. Net ton-miles per freight car day, for example, increased by less than three per cent a year during the 1960's. (And this gain, as noted elsewhere, is explained almost entirely by lengthening of the average haul and the substitution of bigger for smaller capacity cars.) Average freight car turnaround time has not significantly improved, the proportion of empty to loaded car miles has gone up, annual average car mileage in 1970 was no greater in 1970 than in 1960, and average train speed has remained constant. By other tests, such as gross ton-miles per freight train hour (up by about 22 per cent

between 1960 and 1970) and car miles per day (up from 45.7 to 54.6, but with a higher percentage empty), productivity gains were also small. During the 1960's, therefore, the railroads succeeded in getting only somewhat more physical output from their investment.

When one looks at labor productivity the gains have been far more substantial. This reflects a sharp reduction in the number of railroad employees (Table 19). Between 1960 and 1970 the work force was cut by more than 200,000, with only 566,000 people employed in 1970. Since railroad revenue ton-miles had increased over that same period by about 33 per cent, productivity rose rapidly. The Labor Department calculates that output per man-hour climbed at an average annual rate of approximately six per cent during the 1960's.[15]

TABLE 19.—NET INVESTMENT PER EMPLOYEE, CLASS I RAILROAOS, 1960-70

Year	Net investment (Millions of dollars)	Net investment 1960=100	Employees (Thousands)	Employees 1960=100	Net investment per employee (Oollars)	Net investment per employee 1060=100
1960	27, 474	100. 0	780	100. 0	35, 223	100. 0
1961	27, 181	98. 9	718	92. 1	37, 857	107. 5
1962	25, 858	94. 1	700	89. 7	36, 940	104. 9
1963	25, 773	93. 8	680	87. 2	37, 901	107. 6
1964	25, 989	94. 6	665	85. 3	39, 081	111. 0
1965	26, 319	95. 8	640	82. 1	41, 123	116. 8
1966	27, 322	99. 4	631	80. 9	43, 300	122. 9
1967	27, 733	100. 9	610	78. 2	45, 464	129. 1
1968	27, 668	100. 7	591	75. 8	46, 816	132. 9
1969	27, 892	101. 5	578	74. 1	48, 256	137. 0
1970	28, 186	102. 6	566	72. 6	49, 799	141. 4

Source: ICC and AAR.

One suggestive measure is found simply in the ratio of originated tonnage to employment. This shows that in 1960 tons per employee was 1,589; by 1970 this was up to 2,623, an increase of 65 per cent (Table 20). Thus on the labor side the productivity gains have been considerable, at least when measured by physical output indicators.

TABLE 20.—LABOR PROOUCTIVITY, SELECTEO MEASURES CLASS I RAILROAOS, 1960-70

(Except where noted, 1960-100)

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Output per man-hour:[1] Production workers index (1967=100)	63. 2	68. 1	72. 4	76. 9	81. 9	91. 0	97. 6	100. 0	104. 4	109. 3	[2] 109. 9
Output per man-hour:[1] All employees index (1967=100)	63. 6	68. 2	72. 6	77. 1	82. 1	90. 8	97. 5	100. 0	104. 4	109. 2	[2] 109. 7
Originated tonnage per employee (tons)	1, 589	1, 667	1, 762	1, 889	2, 037	2, 168	2, 296	2, 308	2, 422	2, 549	2, 623
Index	100. 0	104. 9	110. 9	118. 9	128. 2	136. 4	144. 5	145. 2	152. 4	160. 4	165. 1
Total labor costs per dollar of net investment	. 195	. 188	. 200	. 199	. 202	. 204	. 202	. 202	. 211	. 219	. 227
Index	100. 0	96. 4	102. 6	102. 1	103. 6	104. 6	103. 6	103. 6	108. 2	112. 3	116. 4
Operating revenue per dollar of labor costs	1. 775	1. 779	1. 882	1. 860	1. 876	1. 901	1. 933	1. 849	1. 858	1. 872	1. 874
Index	100. 0	101. 4	102. 6	104. 8	105. 7	107. 1	108. 9	104. 2	104. 7	105. 5	105. 6
Labor costs per labor costs plus income available for fixed charges (cents)	. 860	. 865	. 841	. 829	. 824	. 810	. 801	. 842	. 843	. 852	. 883
Index	100. 0	100. 6	97. 8	96. 4	95. 8	94. 2	93. 1	97. 9	98. 0	99. 1	102. 7
Labor costs per labor costs plus net railway operating income (cents)	. 902	. 905	. 877	. 864	. 865	. 848	. 841	. 892	. 896	. 903	. 929
Index	100. 0	100. 3	97. 2	95. 8	95. 9	94. 0	93. 2	98. 9	99. 3	100. 1	103. 0
Labor costs per labor costs plus railway operating income (cents)	. 849	. 847	. 823	. 808	. 808	. 788	. 788	. 818	. 815	. 819	. 835
Index	100. 0	99. 8	96. 9	95. 2	95. 2	92. 8	91. 6	96. 3	96. 0	96. 5	98. 4

[1] Class I railroads and Class I switching and terminal companies.
[2] Preliminary.

Source: ICC, Oepartment of Labor and AAR.

Physical measures of a change in productivity—how much more output is being derived per man-hour or dollar of investment—represent but one approach to the issue. The other relates to financial returns: have the railroads been able to increase their earnings relative to the share going to labor and their additional capital investment? In summary, the record shows that from 1960 to 1970 there was about a 23 per cent improvement in the capital/output ratio, with a dollar of net investment "producing" 43 cents of operating revenue in 1970 as

[15] See Appendix, Table A-25.

compared with only 35 cents in 1969 (Table 18). Operating revenue per dollar of labor costs rose about 6 per cent. The result is that despite a sharp decline in the number of workers, the labor share of railway operating income as well as net railway operating income and income available for fixed charges remained about the same or was up somewhat in 1970 compared with 1960. This signifies that the full measure of rising physical labor productivity has been paid out in increased employee compensation.

The pattern of productivity change during the 1960's was highly uneven, however, which further helps explain the problems experienced by the industry in the later years of the decade. Especially noticeable is a sharp break point in capital productivity that took place about 1966. First, though, consider labor productivity, where there was a noticeable yet less pronounced slowdown in the rate of increase. As can be seen in Table 20, aggregative measures of gains in output per man-hour rose steeply from about 1962 through 1966, with annual percentage gains averaging well over six per cent. The freight tons per employee index, as indicated in Table 20, climbed from 105 per cent of the 1960 base in 1961 to 145 per cent in 1966. In the face of these gains total labor costs per unit of net investment held steady from 1962 through 1967, as seen in Table 20. Even more importantly labor costs as a percentage of income available for fixed charges plus labor costs—what has sometimes been called the labor distributive share—fell in the early 1960's. From a value of 86.5 per cent in 1961, the highest it had been since 1950, the labor share declined to 81 per cent in 1965. Seen in another way, labor costs were consuming a smaller proportion of operating revenues. The index of operating revenue per dollar of labor costs rose 9 per cent. From the standpoint of investment efficiency measured in financial terms, the early 1960's were a similarly optimistic period for the railroads. Relative to investment, railway operating income, net railway operating income, and income available for fixed charges all rose steeply through 1966. As seen in Table 18, the net railway operating income/investment index escalated 81 per cent from 1960 to 1966. There were similar sizable though less dramatic gains in the two other financial measures of capital productivity. In short, the railroads were squeezing far more revenue out of their investment and this efficiency was being carried forward into earnings.

In about 1966 railroad fortunes went into sharp reverse, with a particularly marked deterioration in the financial measurements of productivity. The rate of increase in labor output per man-hour slowed considerably, averaging only about three per cent a year from 1966 to 1970—in contrast with gains of more than twice that in the earlier years. This slowdown in labor productivity was not offset by any change in compensation. Total labor costs began to consume a growing share of operating revenue, with the index of operating revenue per dollar of labor costs falling from 108.9 in 1966 to 104.2 in 1967 and rising modestly to 105.6 in 1970. Even more striking, the labor distributive share climbed from 81 per cent in 1965 to more than 88 per cent in 1970 when measured against income available for fixed charges (it also increased in comparison with net railway operating income and railway operating income).

The financial measurements of capital productivity also displayed sharp declines after 1966, with the most pronounced setbacks showing up in earnings. While the index of operating revenue/net investment was higher in 1970 than in 1966 (and 23 per cent more than 1960), the ratio of railway operating income (revenue less expenses) to net investment began to fall in 1967. By 1970 this latter ratio was only 29 per cent above 1960, down from 63 per cent in 1966. Significant though this is, it understates the problem for railway operating income does not take into account the growing costs associated with equipment rentals. If net investment is related to *net* railway operating income, the fall in productivity is dramatically portrayed. In 1966 the investment/NROI index was 181 per cent of the 1960 base, but as shown in Table 18 by 1969 it had fallen to 110 and by 1970 it was down to 81. There was a nearly comparable precipitous decline in the ratio of investment to income available for fixed charges.

From 1966 on, therefore, increasingly more investment was required each year to produce a dollar of net earnings and by 1970 the situation was worse than it had been in 1960. By these tests the improvements in capital productivity that had been made in the first half of the 1960's were dissipated in the decade's later years. Some of this decline, of course, can be explained by falling output, attributable to the general slowdown in the economy, but by no means all of it. The rate of average annual gains in net ton-miles per freight car day from 1967 to 1970 slowed to about half the rate recorded from 1962 to 1966. By 1970 turnaround time was slower than in 1960. The index of ton-miles per dollars of net rail investment showed practically no gain from 1966 through 1970 in contrast with an increase of nearly 30 per cent from 1960 through 1966.

To sum up: for the railroads the 1960's were a decade marked initially by improvement and then by decline in the productivity of their investment. In the earlier years stepped-up capital investment and declining employment resulted in productivity gains and better earnings for the industry. After 1966, however, although labor productivity continued to increase, capital output fell at a substantial rate when measured in financial terms. With the labor share of operating income tending to rise, offsetting gains in physical labor productivity, the effect was to depress earnings. In this later period railroad capital outlays were not contributing to increased efficiency or higher capital productivity. Quite the contrary: capital output was falling, gains in labor productivity were being counterbalanced by rising labor compensation, and there was poorer investment utilization as reflected in financial results. While there were more tons of freight carried per worker and per dollar of investment in 1970 than in 1960, the financial returns on capital—as reflected in the ratio of investment to earnings and in the share of net revenue—were off significantly. Unmistakably investment management has clearly now become the railroad's number one problem.

EFFICIENCY AND SERVICE

The appeal of rail transportation to shippers is a composite of many variables, with the qualitative dimensions of service becoming increasingly important. Rates, always significant of course, are but one aspect of the product the railroads have to offer. As shippers become more sophisticated and come to view the distribution process as a totality, the "cost" of transportation ranges far beyond its quoted price. This is especially the case with higher-valued manufactured goods, whose rate of growth and yield make their movement such a crucial factor in the future development of the railroad industry. The quality of service, important as it is in attracting rail traffic, is largely dependent on the efficiency of rail operations and the utilization of equipment. What this signifies is the interdependence of railroad problems, for without better use of equipment there can neither be improved service nor a more profitable exploitation of the substantial rail capital investment in plant and rolling stock.

From the standpoint of shippers, rail transportation services comes down to a function of:

* rates
* availability
* dependability
* shipment loss and damage

Obviously these can be consolidated into a single cost function, but for present purposes they are best viewed separately. In doing so one finds the keys to some of the railroads' most serious problems—namely, the relatively low overall rate of capital utilization and the generally deteriorating quality of service. Several highlights can be noted:

* There is evidence that shippers have experienced increasing difficulty in recent years in obtaining cars on a predictable schedule. This reflects less an inadequate supply of cars than the absence of a system to manage the distribution of cars.
* In-transit and car delivery schedules have slowed but, more importantly, they have become less reliable.
* Less trains are hauling heavier carloads greater distances. From a service standpoint, these facts suggest that the railroads are concentrating more of their efforts in servicing the relatively small number of big shippers whose rail transportation needs are both great and highly routinized. One result of this concentration of effort, of course, is increasingly poor service to shippers whose demands for rail service are not as great and not as regular.
* Loss and damage claims for rail freight movements have escalated sharply, rising from $167 million in 1967 to more than $224 million in 1970.
* Utilization of the railroads' single biggest category of investment, freight cars, has shown some improvement during the last decade, but almost all of this can be attributed to shipper insistence on larger cars and to lengthier hauls rather than to better management of the car fleet.

With this overview in mind, we can turn to a more detailed examination of the efficiency and service record of the industry in the last decade.

FREIGHT TRAIN INDICATORS

Statistics for all Class I railroads show that both the number of miles and hours logged by freight trains has remained virtually constant during the 1960's (Table 21). Regional figures, however, indicate that there has been a 23 per cent increase in freight train miles for lines in the Southern district, but

a six per cent drop for Eastern district roads. Given the fact that the average length of haul [16] has increased about ten per cent (from 452 to almost 500 miles), it might be expected that a similar increase in freight train miles and hours would be evident. That this is not the case points to the falling number of trains being made up for line haul operation. This is confirmed in Table 21 which shows that more than one million fewer trains were made up in 1970 than in 1960. In short, the combination of fewer trains traveling greater distances has resulted in about the same number of train hours and miles of service in the 1960's.

TABLE 21.—FREIGHT TRAIN MILES AND HOURS AND TRAINS MADE UP FOR LINE HAUL,[1] CLASS I RAILROADS, 1960–70
[Index, 1960=100]

Year—	Freight train miles (thousands)	Index	Freight train hours (thousands)	Index	Number of trains	Index
1960	404, 464	100. 0	20, 708	100. 0	1, 569, 779	100. 0
1961	386, 410	95, 5	19, 460	94. 0	1, 466, 350	93. 4
1962	393, 346	97. 3	19, 653	94. 9	1, 471, 477	93. 7
1963	399, 897	98. 9	19, 899	96. 1	1, 483, 504	94. 5
1964	414, 470	102. 5	20, 548	99. 2	1, 546, 396	98. 5
1965	420, 962	104. 1	20, 977	101. 3	1, 508, 889	96. 1
1966	437, 491	108. 2	21, 597	104. 3	1, 542, 208	98. 2
1967	420, 365	103. 9	20, 669	99. 8	1, 477, 056	94. 1
1968	429, 276	106. 1	21, 031	101. 6	1, 465, 268	93. 3
1969	433, 371	107. 1	21, 561	104. 1	1, 471, 684	93. 8
1970	427, 116	105. 6	21, 247	102. 6	1, 437, 392	91. 6

[1] Total tonnage per average freight train load. Source: ICC and AAR.

Similarly, there has been virtually no change over the decade in the number of cars in the average freight train.[17] (In addition, there has been no change in the tendency for Eastern district railroads to make up slightly longer trains than lines in both the Southern and Western districts). Nevertheless, there has been a steady increase in the amount of freight hauled by the average train.[18] Since there has been no dramatic shift in the type of commodities carried by the railroads, and since the number of cars in the average train has held constant, this steady gain in tons hauled must be attributable to the increase in the size of the newer cars being placed in service. Finally, the 24 per cent increase in gross ton-miles per freight train hour [19] is consistent with other data already presented: heavier trains are traveling greater distances, while their hours of running time have remained unchanged.

FREIGHT CAR INDICATORS

Table 22 presents data regarding loaded car-miles.[20] It indicates that while there has been no change in the *absolute* number of loaded car-miles, there has been a drop (almost seven per cent) in the *ratio* of loaded to total car-miles. Taken together, these probably reflect the increase in empty backhauls resulting from the introduction of unit-trains and specialized equipment. What this suggests is that in accommodating the wishes of a shipper and gaining traffic by supplying specialized equipment, a railroad may or may not benefit depending on the net earnings derived from the relevant movements. If equipment use is sufficiently increased, as it can be with a unit train operation, the investment can be rewarding even though the empty haul ratio is high (i.e., more hauls and reduced turnaround time offsets the empty backhauls). On some special equipment, however, there may be little increase in usage except for short seasonal periods so that the investment, though pleasing to a shipper, may be harmful to the railroad.

[16] See Appendix, Table A–26.
[17] See Appendix, Table A–27.
[18] See Appendix, Table A–28.
[19] See Appendix, Table A–29.
[20] Similar data for selected railroads can be found in Appendix, Table A–30.

TABLE 22.—LOADED FREIGHT CAR MILES, CLASS I RAILROADS, 1960-70

Year	Car-miles loaded (millions)	Index 1957-59=100	Loaded car-miles as percentage of total car-miles	Year	Car-miles loaded (millions)	Index 1957-59=100	Loaded car-miles as percentage of total car-miles
1960	17,287	95.9	61.4	1966	18,304	101.6	60.3
1961	16,648	92.4	61.2	1967	17,449	96.8	58.9
1962	16,990	94.3	61.2	1968	17,825	98.8	59.3
1963	17,133	95.1	60.9	1969	17,965	98.9	59.2
1964	17,487	97.1	60.6	1970	17,300	96.0	57.8
1965	17,885	99.3	61.0				

Source: ICC and AAR.

The trend toward building larger freight cars is reflected in a gain of over 11 tons in the capacity of the average car over a ten-year period.[21] Reflecting this gain in capacity is a similar increase in the average freight car load (Table 23). It is interesting to note, in this respect, that the industry employs two methods for calculating the average freight car load. One procedure simply measures the weight of originated freight, while the other, based on operating statistics, introduces distance factors. It is clear from Table 23 that when the first method is used, only a 23 per cent increase is seen, whereas operating data suggest an increase of 32 per cent.

TABLE 23.—AVERAGE FREIGHT CARLOAD, CLASS I RAILROADS, 1960-70

Year	Tons per originated carload	Index, 1960=100	Net ton miles per loaded car mile	Index, 1960=100
1960	44.4	100.0	34.0	100.0
1961	44.9	101.1	34.7	102.1
1962	45.4	102.2	35.7	105.0
1963	46.7	105.2	37.1	109.1
1964	47.8	107.7	38.3	112.6
1965	48.9	110.1	39.6	116.5
1966	50.1	112.8	40.3	118.5
1967	51.1	115.1	41.2	120.9
1968	51.8	115.7	43.0	126.5
1969	53.1	119.6	43.5	127.9
1970	[1] 54.6	123.0	44.9	132.1

[1] Estimated.

Source: ICC and AAR.

Along with these increases in freight car capacity and load, there has also been a rise in daily car mileage (Table 24). While the 20 per cent increase in car mileage is consistent with earlier data indicating an increasing length of haul, nevertheless this statistic should be regarded with some caution. The daily car mileage figure is calculated for serviceable freight cars both loaded and empty.[22] Since there has been a drop in the percentage of loaded to total freight car miles, it must follow that the rise in daily car mileage includes an increase of "light" car-miles.

TABLE 24.—DAILY CAR MILEAGE AND TIME AVERAGE CAR SPENDS IN FREIGHT TRAINS [1], CLASS I RAILROADS, 1960-70

Year	Miles	Index, 1960=100	Hours per day in freight train	Index, 1960=100
1960	45.7	100.0	2.34	100.0
1961	45.5	99.6	2.29	97.9
1962	47.6	104.2	2.27	97.0
1963	49.2	107.7	2.38	101.7
1964	50.0	109.4	2.48	106.0
1965	51.7	113.1	2.57	109.8
1966	53.0	116.0	2.61	111.5
1967	51.5	112.7	2.54	108.5
1968	53.5	117.1	2.62	112.0
1969	54.9	120.1	2.73	116.7
1970	54.6	119.5	2.72	116.2

[1] Daily car mileage times average freight train speed.

Source: ICC and AAR.

[21] See Appendix, Table A-31.
[22] For data on car serviceability, see Appendix, Table A-32.

An oft-cited composite index of freight car efficiency is "net ton-miles per freight car day." Table 25 reports that this measure is up almost 50 per cent since 1960. The gain in this item is due primarily to the increase already noted in the average freight car load. To a lesser extent, the gain in daily car mileage is also responsible. Clearly, however, the increase is not due to the percentage of freight car miles loaded for this statistic, as we have just seen, has declined. Since the performance of this key index of efficiency is so dependent on the weight of the average carload of freight, it is important to recall how this latter item can be computed. When based on statistics that take length of haul into account the average freight car load shows a far greater increase than when calculated on a mere tonnage basis. The nearly 50 per cent increase in "net ton-miles per freight car day," therefore, results from inclusion of distance; if the tonnage figure were to be substituted, only a 38 per cent increase in freight car efficiency would be indicated. Before leaving this efficiency indicator, it is useful to note the great variance in performance by different roads. Whereas the Southern and Union Pacific have registered increases well above the national average, the Illinois Central and Norfolk & Western are below the national norm while the Penn Central and Southern Pacific closely follow the performance of all Class I roads.

TABLE 25.—NET TON-MILES PER FREIGHT CAR DAY, CLASS I RAILROADS, REGIONAL DISTRICTS, AND SELECTED RAILROADS, 1960–70

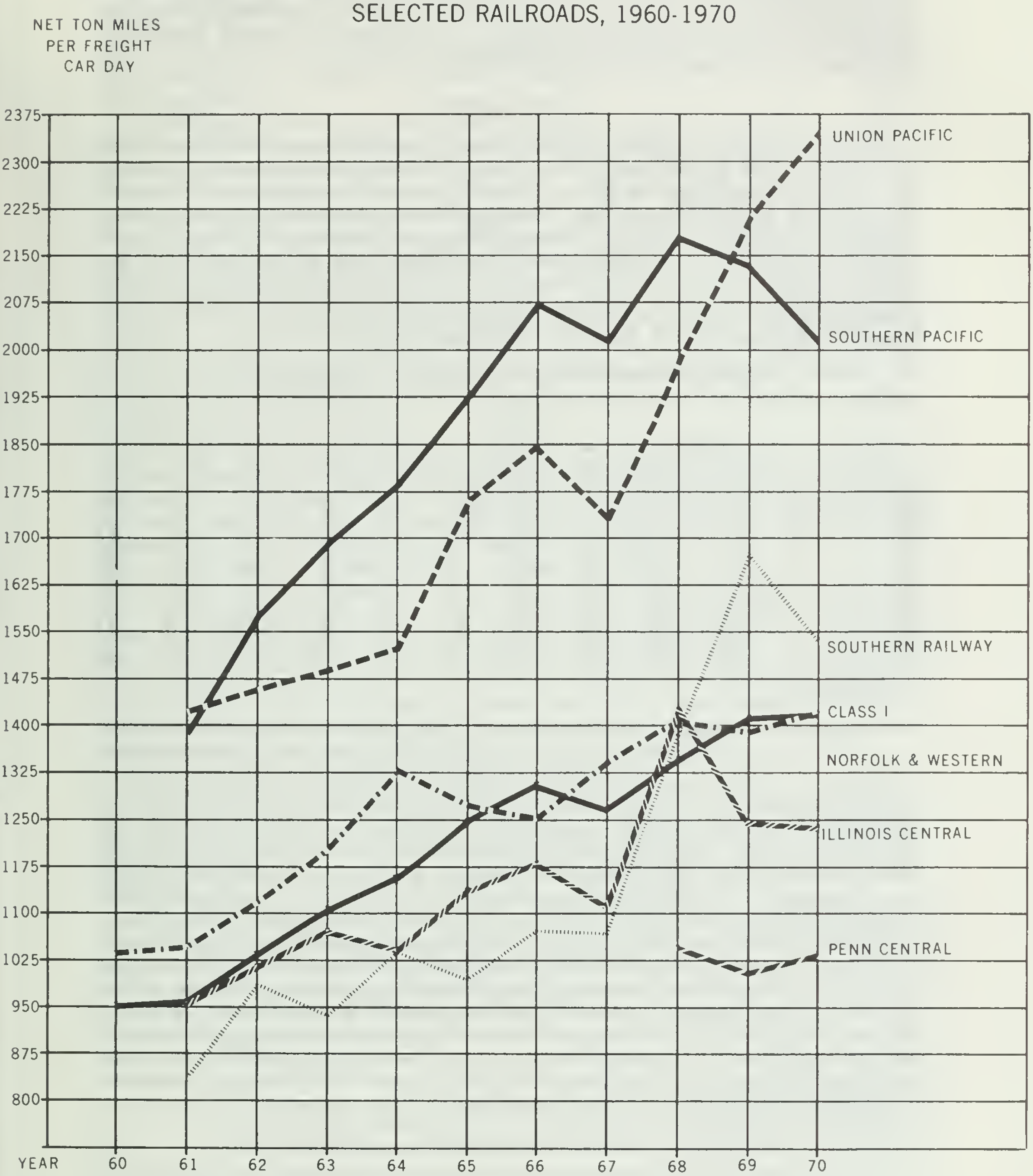
	Year										
	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I Railroads	954	966	1,041	1,113	1,160	1,251	1,310	1,271	1,350	1,416	1,418
Eastern District	805	813	880	942	1,006	1,079	1,108	1,094	1,103	1,124	1,128
Penn Central									1,050	1,005	1,033
Pennsylvania	635	638	694	734	989	1,021	1,113	1,063			
New York Central	674	680	729	766	908	966	974	916			
Norfolk & Western	1,038	1,046	1,119	1,209	1,328	1,281	1,259	1,352	1,411	1,393	1,422
New York, Chicago & St. Louis	1,096	1,056	1,092	1,266							
Southern District	934	942	1,005	1,084	1,102	1,206	1,286	1,264	1,392	1,487	1,403
Southern Railway	(1)	843	990	939	1,040	997	1,077	1,073	1,390	1,673	1,543
Illinois Central	(1)	961	1,019	1,078	1,047	1,143	1,187	1,114	1,429	1,249	1,243
Western District	1,131	1,140	1,232	1,313	1,347	1,453	1,529	1,455	1,593	1,694	1,735
Southern Pacific	(1)	1,394	1,581	1,696	1,790	1,929	2,075	2,020	2,188	2,141	2,024
Union Pacific	(1)	1,425	1,465	1,493	1,528	1,768	1,850	1,741	1,992	2,209	2,354

1 Not available.

Sources: Class I Railroads and Regional Districts—ICC and AAR: Selected Railroads—Moody's Transportation Manual.

CHART 9

NET TON MILES PER FREIGHT CAR DAY, CLASS I RAILROADS AND SELECTED RAILROADS, 1960-1970



To summarize at this point, two major tendencies in freight car efficiency can be highlighted: first, the average car, when loaded, is carrying more (primarily because of increased capacity) and is traveling farther (primarily because of the greater length of haul); second, however, more freight cars are being hauled "light," probably because of an increase in empty back-hauls resulting from the use of more specialized equipment.

CAR UTILIZATION

Data relating to car use provides a more specific picture of trends in the service aspects of the industry. Despite the rather significant increase in daily car mileage, the average freight car is making about the same number of trips now as it did in 1960 (Table 26). This tends to confirm other data suggesting that the increase in car mileage is owed to longer hauls rather than any increase in trip frequency. Certain types of cars—notably open top hoppers and flat cars—show gains in the number of trips per year, but for the boxcar, which accounts for about 40 per cent of the total fleet and is most needed by the general shipper, there has been a decline in the number of trips.

TABLE 26.—TRIPS PER YEAR BY TYPE OF CAR, CLASS I RAILROADS, 1958-69

Year	Boxcar	Refriger-ator car	Gondola car	Hopper car: Open top	Hopper car: Covered	Stock car	Flatcar	Tank car	Other	Total
1958	19.3	11.9	15.9	19.7	17.4	9.4	16.3	17.4	21.6	18.1
1959	20.1	11.9	17.5	21.3	18.7	9.9	20.2	16.9	24.1	19.2
1960	19.1	11.6	17.4	22.3	17.5	9.0	23.5	16.8	24.3	19.8
1961	18.5	11.3	16.2	21.3	16.7	7.9	24.2	16.6	23.6	18.1
1962	18.8	11.8	16.4	22.2	17.0	7.9	26.7	16.4	24.7	18.4
1963	18.8	11.1	17.8	24.0	17.5	6.9	28.4	14.8	24.2	19.9
1964	18.2	10.6	19.2	25.3	17.6	7.3	30.6	14.1	26.6	19.5
1965	18.8	9.9	19.2	25.9	17.7	6.5	31.7	13.8	26.0	20.9
1966	18.9	9.2	19.1	26.3	18.1	6.6	29.7	14.0	25.4	20.3
1967	16.5	10.4	18.6	25.1	16.8	5.6	28.1	14.5	26.7	19.3
1968	16.9	10.6	18.5	25.0	17.2	5.4	30.2	14.8	26.3	19.2
1969	16.8	10.9	18.9	26.2	17.6	5.6	29.4	14.3	26.8	19.5

Source: AAR

Critical to the subject of car utilization is the question of turnaround time. In the last ten years there has been some marginal improvement in turnaround time, but even with these gains some two and a half weeks are still consumed by such procedures for an average movement (Table 27). Available data indicate, however, that there is considerable variance in turnaround times for different types of equipment. Hoppers and flat cars, for example, achieved turnaround times of slightly less than 14 days in 1970, an improvement of two days compared with 1960. On the other hand, there was a deterioration with respect to box and refrigerator cars so that by 1970 over three weeks of turnaround time was required, a decline of 17 percent from 1960. Although small, the gain in turnaround time for the average car has occurred at the same time that trip distances have increased. In 1970 a freight car spent close to two and three-quarter hours in road trains or about 15 per cent more time than in 1960 (Table 24). Since there has been no reduction in train speed,[23] this 15 per cent increase must be attributable to the rise in car mileage. In order for there to have been any improvement in turnaround time, therefore, some improvement took place in terminal and classification procedures.

TABLE 27.—TURNAROUND TIME—DAYS, CLASS I RAILROADS, SELECTED YEARS

	1960	1965	1970
Box	19.18	19.40	22.35
Refrigerators	31.51	36.97	33.21
Gondolas	20.99	18.99	19.12
Hoppers	16.41	14.11	13.94
Covered hoppers	20.94	20.63	20.23
Flat	15.59	11.51	13.46
Average all cars	19.16	18.02	18.73

Source: ICC.

[23] Appendix, Table A–33 contains data regarding average freight train speed and Table A–34 reports locomotive utilization statistics.

Encouraging as this may be, however, it is still true that on the average a freight car is in line haul movement only about 12 per cent of the time. With another 40 per cent of the time spent loading and unloading, about half a car's time is spent either waiting movement or sitting idle for assignment. This represents very low utilization of railroad investment. From the viewpoint of the rail shipper, the problem is compounded by the decline in service reliability, with delays of as much as one week in actual versus promised train arrivals not uncommon.

These facts point to the heart of the so-called freight car shortage problem: poor use of existing equipment. To some extent, shippers themselves contribute to poor utilization by not loading and unloading cars quickly. (Even with increased demurrage charges, the freight car can be a cheap warehouse.) But even more critical is the absence of any surety on the part of the shipper respecting car availability, which prevents efficient scheduling of loadings and unloadings. One shipper has estimated that if the railroads could deliver 90 per cent of cars to his loading docks within a "target" 72 hour time frame, his freight car demands could be cut by as much as 45 per cent, a staggering amount. Furthermore, such delivery reliability would result in greater utilization of less equipment because an additional carloading per month could be achieved with the reduced rolling stock required. In a test of these guidelines, however, the railroads only managed to deliver about 66 per cent of the equipment within the three day "target" period.

It is this kind of poor service record that is most telling. Not only does it seriously compromise other statistics which suggest gains in rail service, it also indicates that in essence the so-called freight car shortage problem is less one of equipment supply than of poor utilization. This hampers the railroads in the marketing of their service and, as noted elsewhere, it also imposes a severe financial strain by inhibiting better capital productivity.

Discussion of the adequacy of service points to the highly significant interlocking relationship between this facet of rail operations and the capital investment needs of the industry. One way of demonstrating the sensitivity of railroad capital requirements to car utilization is to examine industry projections of future rail investment needs. Consider the conclusions reached in the industry's 1970 ASTRO report. It proposed expenditures from 1970 through 1980 of $18.6 billion for freight cars, a dollar amount equal to half the total expenditure forecast. This conclusion was based on several assumptions:

* a 3.5 per cent annual increase in traffic
* a relatively stable railroad share of total intercity freight movement
* a modest (and unexplained) 1.5 per cent increase in car utilization

This led to the determination that a two per cent annual increase in the number of freight cars was required, a conclusion carrying with it the $18 billion-plus price tag.

As one looks at these assumptions one can see that even modest differences greatly alter the investment implications. Even if it is granted that traffic will grow at 3.5 per cent a year and that the railroads' share will remain about what it was in 1970—two assumptions open to debate—the low rate of projected increased car utilization becomes critical. If car utilization (as measured by net ton-miles per freight car day) were to increase at 3.5 per cent a year, capital needs would be slashed sharply, since no net increase in the freight car fleet would be required. Whether such a gain in utilization is possible depends on recent railroad experience and on the prospect that the same underlying casual factors may prevail in the future. As noted earlier, the railroads have improved their car use by about 50 per cent in the last ten years. It will be recalled, though, that the gains have come about almost entirely because of larger cars and a longer average length of haul, not because of better management of the car fleet. With average freight car capacity having climbed from 55.4 tons in 1960 to 67.1 tons in 1970, it is doubtful whether comparable gains, at least in percentage terms, can be expected to continue. As for length of haul, movement distances have increased abont ten per cent in the last ten years, but here, too, it is questionable whether similar changes will take place in the next decade.

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With the two key elements that have led to improved freight car utilization unlikely to be as significant in the near future, the importance of the fact that the railroads themselves have been unable to make better use of their rolling stock investment is accentuated. Recent experience shows that in some types of movements, such as those involved in unit trains, the railroads have bettered their use of some freight cars (more revenue-generating traffic carried per unit of time and unit of investment). Generally, however, this has not been the case. In fact, from 1966 to 1969 car trips per year declined over two per cent. Take boxcars as a specific example. In 1960 the average boxcar made 19.1 trips a year; in 1969 this figure dropped to 16.8 trips, a deterioration of considerable magnitude.

With so much railroad investment in freight cars and with no improvement in car utilization (except as it has come about through longer average hauls and bigger unit capacity), even a forecast of an annual improvement of 1.5 per cent in productivity might be regarded as excessively optimistic. To say that, though, is only to dramatize the critical character of better car use and to point up the necessity for better rolling stock management by the railroads themselves. This brings us back to the interlocking character of the basic problem. Clearly the railroads must squeeze more revenue out of their car investment, but that will come about only if shippers can be assured a higher degree of reliability of service (i.e., car supply and schedule dependability) and, in turn, that depends on improved car management. If, as noted elsewhere, carloadings could be increased significantly from their present average of about 1.6 per month, better service could be provided with a much smaller fleet than now exists. To achieve this result calls, not simply for putting more cars into the system, but controlling more effectively those in service. The payoffs are obviously large, in terms of capital productivity, traffic participation, and revenue generation.

MARKETING AND TRAFFIC

Railroads earn revenue by providing transportation—obvious enough—but it is in the marketing of that service and in the use of the substantial associated investment are the more subtle underlying and inter-related aspects of the railroad problem. From the standpoint of the freight shipper the absolute and relative appeal of rail transportation comes down to a question of its total distribution costs—which is a function of price and quality (dependability, speed, damage susceptibility, etc.). Seen through railroad eyes satisfaction of shipper desires reduces also to a question of costs, particularly those related to the use of what is the industry's largest investment commitment, the freight car fleet.

In matching up rail service with shipper requirements there is clearly a wide range of demand elasticities, with some movements having little alternative other than rail while many others are highly sensitive to relatively small changes in price and service quality as between the modes. It is in the area of higher demand elasticity, one made up significantly of manufactured goods, that service quality considerations become critical and where the greatest traffic potential and revenue yields are to be found. If this potential is to be realized, however, aggressive, highly flexible marketing is imperative, with sensitive adaptation of rates and service to carefully defined markets. To say this, though, is not to belie the complexity of the matter. Among other things, meeting increasingly refined shipper demands necessitates large capital outlays (e.g., for specialized rolling stock) which can be counterproductive unless there is improved use of investment. Fortunately, better utilization can complement a carefully structured marketing program since it implies faster turnaround of equipment, something of distinct appeal to shippers. This is hardly to suggest that the challenges confronted by carrier management are easily met, but it does point up the interlocking character of the basic problem—with investment, operational efficiency, marketing, and public policy all playing a significant and interdependent role. With these thoughts to serve, then, as a point of reference, a more specific review of railroad traffic—its volume and composition—is in order, one that takes into account the differences among individual roads.

TONNAGE [24]

As evidenced in Table 28, all Class I railroads considered together have experienced a relatively modest 20 per cent increase in traffic in the ten year period ending in 1970. The decade can conveniently be divided into two periods: through 1966 the industry registered annual gains of over three per cent (1965 excepted); in the last four years of the period traffic declined considerably, with an actual drop in traffic in 1967 and 1970 and only small increases in 1968 and 1969. Thus by the end of the decade the rail system as a whole was hauling slightly less traffic than it had been in 1966.

[24] As used here, tonnage refers to both originated and received tonnage.

TABLE 28.—TONNAGE (ORIGINATED AND RECEIVED), CLASS I RAILROADS AND SELECTED RAILROADS, 1961–70

(Thousands, 1961 = 100)

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroads	2,192,193	2,271,960	2,358,771	2,502,069	2,542,478	2,644,887	2,570,077	2,590,593	2,654,918	2,616,055
Index	100.0	103.6	107.6	114.1	116.0	120.7	117.2	118.2	121.1	119.3
Penn Central[1]	275,853	290,141	297,166	313,506	319,900	322,558	310,837	285,634	300,005	281,724
Index	100.0	105.2	107.7	113.6	116.0	116.9	112.7	103.5	108.8	102.1
Pennsylvania	152,876	161,173	164,267	173,452	177,251	183,104	175,759	----------	----------	----------
New York Central	122,977	128,968	132,899	140,054	142,649	139,454	135,079	----------	----------	----------
Norfolk & Western[2]	116,815	119,966	127,459	([3])	166,632	169,014	161,415	165,334	169,169	164,052
Index	100.0	102.7	109.1	----------	142.6	144.7	138.2	141.5	144.8	140.4
Southern Railway	68,145	72,772	76,676	82,195	88,335	92,512	95,388	102,411	107,678	108,275
Index	100.0	106.8	112.5	120.6	129.6	135.8	140.0	150.3	158.0	158.9
Illinois Central	65,187	70,262	74,917	75,191	75,235	78,756	79,795	80,977	81,078	85,488
Index	100.0	107.8	114.9	115.3	115.4	120.8	122.4	124.2	124.4	131.1
Southern Pacific	99,281	98,896	102,737	108,560	117,833	121,942	112,130	122,407	129,715	126,198
Index	100.0	99.6	103.5	109.3	118.7	122.8	112.9	123.3	130.6	127.1
Union Pacific	55,999	56,993	59,917	62,842	64,729	67,889	66,207	68,426	71,551	74,038
Index	100.0	101.8	107.0	112.2	115.6	121.2	118.2	122.2	127.8	132.2

[1] 1961–67 pro forma.
[2] 1961–64 pro forma estimate.
[3] Not available.

Source: Class I railroads—ICC and AAR; selected railroads—Moody's Transportation Manual.

As Table 28 also indicates, however, the traffic generation picture of various individual railroads deviates sharply from the national pattern. The Penn Central, for example, closely follows the national trend through 1965, but falls off thereafter. On the other hand, two Western District roads, the Union Pacific and the Southern Pacific, follow the trend for all Class I railroads through 1968, but then register gains that far exceed the aggregated figures. Of special interest are the data reported for the two Southern District lines examined, the Southern and the Illinois Central. No doubt reflecting the economic growth prevalent in this territory, these lines record traffic gains even in those years when the national totals are in decline.

At this point, it is worth considering the impact of the selected lines on the national figures. Despite the large gains registered by the Union Pacific and Southern Pacific, their respective shares of total rail tonnage in 1970 were still below five per cent. On the other hand, the relatively stagnant performance of the Penn Central more directly affects national totals when it is realized that it hauls over ten per cent of all rail tonnage.[25]

When the concept of distance is considered along with tonnage, the picture for the industry is not altered markedly. In Table 29, it can be seen that all Class I roads experienced a 35 per cent increase in ton-miles hauled. For the most part, the better performance indicated for ton-miles in contrast to tonnage reflects gains in the length of haul (increases in mileage were recorded for all years except 1964). Again, 1967 serves as a distinct break-point for the decade: up to that year annual gains of over five per cent can be noted, while thereafter increases of only three per cent (1968 and 1969) are interspersed with declines in 1967 and 1970. Table 29 also reports data for the major geographical regions and various railroads within them. In comparison with ten year improvements of 60 and 38 per cent in the Southern and Western Districts, the Eastern region is up only 22 per cent and therefore acts adversely on the national statistics.

TABLE 29.—REVENUE TON-MILES, CLASS I RAILROADS, REGIONAL DISTRICTS AND SELECTED RAILROADS, 1961–70

[Millions; 1961=100]

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroads	563,361	592,862	621,737	658,639	697,878	738,395	719,498	744,023	767,841	762,431
Index	100.0	105.2	110.4	116.9	123.9	131.1	127.7	132.1	136.3	135.3
Eastern district	208,550	220,216	230,382	244,691	259,477	265,504	258,361	259,391	259,827	254,694
Index	100.0	105.6	110.5	117.3	124.4	127.3	123.9	124.4	124.6	122.1
Penn Central [1]	72,725	76,698	78,806	83,601	89,128	92,061	89,630	86,561	88,156	83,955
Index	100.0	105.5	108.4	115.0	122.6	126.6	123.2	119.0	121.2	115.4
Pennsylvania	42,071	45,239	46,396	49,765	51,755	53,316	50,730			
New York Central	30,654	31,459	32,410	33,835	37,373	38,744	38,901			
Norfolk & Western [2]	31,249	32,086	34,581	45,405	48,301	50,194	49,039	51,396	52,928	52,815
Index	100.0	102.7	110.7	145.3	154.6	160.6	156.9	164.5	169.4	169.0
Southern district	87,873	95,829	102,532	108,316	116,836	125,462	127,988	130,686	139,256	140,034
Index	100.0	109.1	116.7	123.3	133.0	142.8	145.7	148.7	158.5	159.4
Southern Railway	14,931	15,941	17,164	18,533	20,100	21,356	21,933	23,820	25,601	26,111
Index	100.0	106.8	115.0	124.1	134.6	143.0	146.9	159.5	171.5	174.9
Illinois Central	16,954	19,681	19,582	20,556	21,926	22,831	22,410	23,700	24,673	23,701
Index	100.0	116.1	115.5	121.2	129.3	134.7	132.2	139.8	145.5	139.8
Western district	266,938	276,818	288,823	305,631	321,564	347,429	333,149	353,946	368,757	367,703
Index	100.0	103.7	108.2	114.5	120.5	130.2	124.8	132.6	138.1	137.7
Southern Pacific	50,740	54,697	56,617	60,479	64,813	69,330	66,845	73,520	75,480	74,115
Index	100.0	107.8	111.6	119.2	127.7	136.6	131.7	144.9	148.8	146.1
Union Pacific	32,409	33,188	35,076	37,949	38,883	41,766	41,071	44,133	46,483	47,575
Index	100.0	102.4	108.2	117.1	119.8	128.9	126.7	136.2	143.4	146.8

[1] 1961–67 pro forma.
[2] 1961–64 pro forma estimate.

Sources: Class I railroads and regional districts—ICC and AAR; selected railroads—Moody's Transportation Manual.

Important to these considerations is the question of how traffic is generated. Of the six lines selected for close study, four (the Illinois Central, Norfolk & Western, Southern Pacific, and Union Pacific) can be classified as originating lines in the sense that over 60 percent of their tonnage begins its trip on line (Table 30). In contrast, the Penn Central and the Southern tend to haul about as much originated freight as that received from other carriers. Thus any generalization suggesting, for example, that Eastern District roads are receiving carriers is belied by the case of the N&W. Similarly, there is no consistency with respect to the Southern District roads.

[25] See Appendix, Table A–35.

TABLE 30.—ORIGINATED TONNAGE AS A PERCENT OF TOTAL FREIGHT TONNAGE, SELECTED RAILROADS, 1961-70

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Penn Central[1]	49	50	51	51	51	51	49	51	51	51
Norfolk & Western[2]	71	71	72	(3)	70	70	72	72	71	72
Southern Railway	48	47	48	49	49	49	51	51	51	50
Illinois Central	70	69	70	69	69	67	71	72	73	75
Southern Pacific	69	69	68	70	70	70	67	69	68	69
Union Pacific	61	61	62	61	60	6C	60	60	61	63

[1] 1961-67 pro forma.
[2] 1961-64 pro forma.
[3] Not available.

Source: Moody's Transportation Manual.

General railroad theory holds that lines which have significant amounts of terminal traffic are likely to be burdened with costly turnaround expenses. For most of the lines examined, the extent to which they are terminating traffic which they originate has changed very little over the decade.[26] There are, however, two notable exceptions. First, both Eastern District roads are terminating ten per cent more of their originating traffic now than they did in 1965. In the case of both the Penn Central and the N&W, there were significant gains in this item after their respective mergers. Second, the Union Pacific terminated six per cent less of its originated traffic in 1970 compared with 1960—a downward trend that began in 1964.

What is the picture with respect to received freight? Consider those lines handling significant amounts of this kind of traffic.[27] The data shows that for the Southern there has been a drop of seven per cent in the amount of received traffic terminated, but the Penn Central has experienced an increase of 11 per cent. While this gain for the Penn Central is not extraordinary (the other lines—except for the Southern—also registered 11–12 per cent increases), it is significant when it is recalled that half of Penn Central's total traffic is in received freight.

If the statistics for terminated traffic of both originated and received freight are combined, it is clear that the Eastern roads are increasingly burdened.[28] Overall, the Penn Central and the Norfolk & Western have registered gains of ten and eleven per cent respectively in the amount of total traffic terminated, whereas the other lines are terminating about the same percentage now as at the beginning of the decade.

REVENUE

In the earlier discussion of tonnage, it was noted that 1967 was a critical year for the industry as a whole. Up to that point traffic had increased steadily, but thereafter the railroads experienced either relatively modest increases in tonnage or absolute declines. For the revenue side of the picture, 1967 serves as a crucial benchmark as well. Through that year the annual changes in revenue did not exceed five per cent and (with the exception of 1961 and 1967) these changes were steadily upward (Table 31). These gains in revenue closely track similar gains in traffic. However for the last three years, the revenue gains were far more dramatic—averaging 6.2 per cent— at times when traffic gains were negligible or non-existent. The net result is that whereas traffic increased 20 per cent over the decade, freight revenues jumped 41 per cent.

[26] See Appendix, Table A-36.
[27] See Appendix, Table A-37.
[28] See Appendix, Table A-38.

TABLE 31.—FREIGHT REVENUE, CLASS I RAILROADS, REGIONAL DISTRICTS AND SELECTED RAILROADS, 1961–70

[Thousands, 1961=100]

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroads	$7, 739, 044	$7, 991, 146	$8, 146, 131	$8, 455, 457	$8, 835, 958	$9, 280, 613	$9, 130, 233	$9, 749, 788	$10, 346, 258	$10, 921, 813
Index	100.0	103.3	105.3	109.3	114.2	119.9	118.0	126.0	133.7	141.1
Eastern district	$2, 988, 742	$3, 108, 992	$3, 161, 753	$3, 289, 874	$3, 443, 217	$3, 524, 555	$3, 451, 354	$3, 646, 182	$3, 772, 552	$3, 953, 761
Index	100.0	104.0	105.8,	110.1	115.2	117.9	115.5	122.0	126.2	132.3
Penn Central [1]	$1, 072, 590	$1, 122, 771	$1, 117, 371	$1, 171, 253	$1, 221, 557	$1, 248, 544	$1, 213, 736	$1, 251, 816	$1, 344, 578	$1, 392, 367
Index	100.0	104.7	104.2	109.2	113.9	116.4	113.2	116.7	125.4	129.8
Pennsylvania	$613, 918	$649, 451	$642, 611	$676, 384	$703, 318	$718, 920	$702, 422			
New York Central	$458, 672	$473, 320	$474, 760	$494, 872	$518, 239	$529, 624	$512, 271			
Norfolk & Western [2]	$472, 376	$489, 657	$514, 195	$542, 762	$558, 522	$579, 304	$563, 380	$613, 447	$652, 340	$704, 992
Index	100.0	103.6	108.8	114.9	118.2	122.6	119.3	129.9	138.1	149.2
Southern district	$1, 155, 072	$1, 214, 584	$1, 245, 554	$1, 305, 628	$1, 353, 989	$1, 441, 503	$1, 474, 874	$1, 583, 929	$1, 747, 951	$1, 880, 425
Index	100.0	105.2	107.8	113.0	117.2	124.8	127.7	137.1	151.3	162.8
Southern Railway	$229, 407	$240, 312	$248, 794	$263, 319	$276, 911	$291, 265	$295, 278	$323, 720	$357, 061	$393, 402
Index	100.0	104.7	108.4	114.8	120.7	127.0	128.7	141.1	155.6	171.5
Illinois Central	$203, 177	$216, 109	$223, 363	$231, 402	$238, 774	$251, 903	$256, 144	$264, 144	$283, 782	$302, 035
Inde	100.0	106.4	109.9	113.9	117.5	124.0	126.1	130.0	139.7	148.8
Western district	$3, 595, 231	$3, 667, 570	$3, 738, 825	$3, 859, 955	$4, 038, 751	$4, 314, 554	$4, 204, 006	$4, 519, 678	$4, 825, 754	$5, 080, 857
Index	100.0	102.0	104.0	107.4	112.3	120.0	116.9	125.7	134.2	141.4
Southern Pacific	$606, 108	$631, 057	$638, 193	$664, 794	$728, 354	$764, 168	$749, 278	$817, 864	$881, 611	$895, 923
Index	100.0	104.1	105.3	109.7	120.2	126.1	123.6	134.9	145.4	147.2
Union Pacific	$432, 656	$442, 509	$452, 408	$472, 070	$493, 546	$522, 036	$515, 751	$549, 963	$587, 008	$630, 153
Index	100.0	102.3	104.6	109.1	114.1	120.7	119.2	127.1	135.7	145.6

[1] 1961–67 pro forma.
[2] 1961–64 pro forma estimate; 1961–64 freight revenue includes other revenue.

Sources: Class I railroads and regional districts—ICC and AAR; Selected Railroads—Moody's Transportation Manual.

For some of the individual railroads examined, the revenue patterns do not differ markedly from these national trends. But as with the traffic data previously discussed, certain roads do show deviations. First, the relatively better performance of the Southern District roads is apparent. And again the Penn Central stands out: where the railroad's performance closely paralleled the Class I trends through 1965, the failure to keep pace afterwards—even with the general rate increases granted after 1966—is in significant contrast to the other lines studied. As with the tonnage data, the importance of the Penn Central in the total revenue posture of the industry is crucial. Despite the line's poor performance, it still accounted for almost 13 per cent of total rail freight revenue in 1970.

REVENUE PER TON-MILE

In light of the data already presented concerning traffic and revenues, the pattern of the standard index of railroad yields, revenue per ton mile, should not be surprising. Once again the pre-1967 years are in sharp distinction from the last part of the decade. The combination of gains in traffic outstripping increases in revenue (the pattern for 1962–66) was associated with a steady reduction in yield through 1966 (Tables 32 and 33). However, in the most recent four years revenue per ton mile rose so that by 1970 it has surpassed the 1960 figure.

TABLE 32.—REVENUE (CENTS) PER TON-MILE, CLASS I RAILROADS, REGIONAL DISTRICTS, AND SELECTED RAILROADS, 1960–70

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroads	1.403	1.374	1.348	1.310	1.284	1.266	1.257	1.269	1.310	1.347	1.432
Eastern district	1.471	1.435	1.413	1.373	1.344	1.327	1.328	1.336	1.406	1.452	1.552
Penn Central [1]	(2)	1.475	1.464	1.418	1.401	1.371	1.356	1.354	1.446	1.525	1.658
Pennsylvania	1.500	1.460	1.440	1.390	1.360	1.360	1.350	1.380			
New York Central	1.570	1.500	1.500	1.460	1.460	1.390	1.370	1.320			
Norfolk & Western [3]	1.538	1.512	1.526	1.487	1.195	1.160	1.150	1.150	1.190	1.230	1.340
Southern district	1.326	1.314	1.267	1.215	1.205	1.159	1.149	1.152	1.212	1.255	1.343
Southern Railway	(2)	1.540	1.510	1.450	1.420	1.138	1.360	1.350	1.360	1.390	1.450
Illinois Central	(2)	1.200	1.140	1.140	1.170	1.130	1.140	1.180	1.150	1.190	1.320
Western district	1.373	1.347	1.325	1.294	1.263	1.256	1.242	1.262	1.277	1.309	1.382
Southern Pacific	(2)	1.380	1.340	1.310	1.280	1.290	1.260	1.280	1.340	1.340	1.390
Union Pacific	(2)	1.340	1.330	1.290	1.250	1.240	1.240	1.260	1.240	1.290	1.320

[1] 1960–67 pro forma.
[2] Not available.
[3] 1960–64 pro forma estimate.

Source: Class I railroads and regional districts—ICC and AAR; Selected railroads—Moody's Transportation Manual.

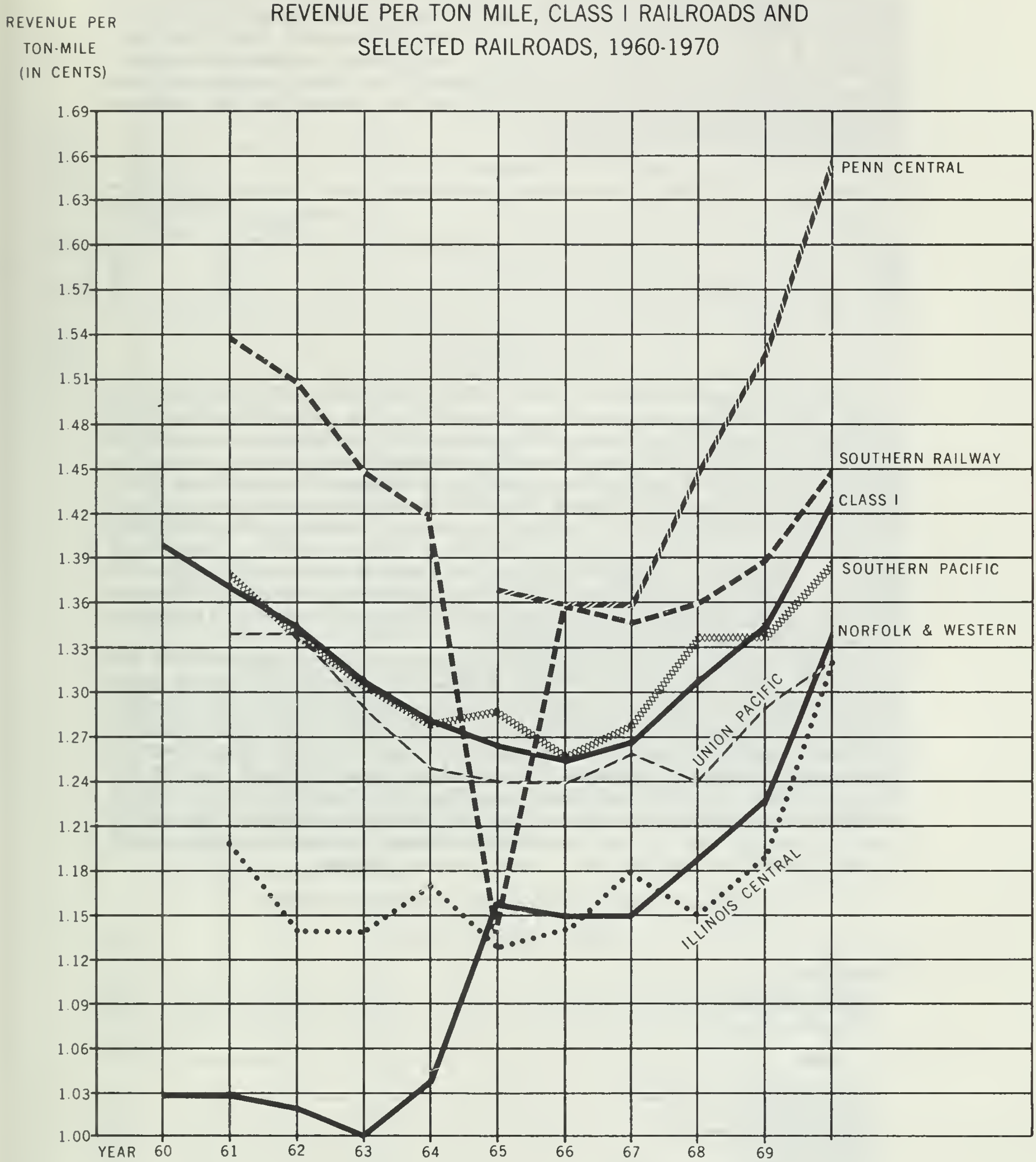
TABLE 33.—RELATIONSHIP OF CHANGES IN RAIL TRAFFIC TO CHANGES IN GNP AND AVERAGE REVENUE YIELD, 1960–70

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Percent change from prior year in:										
Average revenue per ton-mile	−2.1	−1.8	−2.8	−3.1	−1.4	−0.06	−0.09	+3.3	+2.8	+6.0
Originated tonnage	−3.8	+3.3	+4.2	+5.4	+2.4	+4.4	−2.8	+1.7	+2.9	−1.1
Gross national product	+1.9	+6.6	+4.0	+5.4	+6.3	+6.5	+2.6	+4.7	+2.8	−0.4

Source: ICC and AAR.

CHART 10

REVENUE PER TON MILE, CLASS I RAILROADS AND SELECTED RAILROADS, 1960-1970



In Table 32, the significance of the Penn Central and the Southern in the national figures is apparent: in every year for which data are available, the yields of these lines are greater than for all Class I roads together. Previously the impact of the Penn Central on national statistics has been noted. It is provocative, therefore, to indicate the extent to which that road boosts the aggregate yield figure for the entire Class I rail system. The following table compares revenue per ton-mile for all Class I roads in the post-1966 period with the Penn Central included and then excluded:

[In cents]

Year	All class I roads	All class I roads except PC
1967	1.27	1.26
1968	1.31	1.29
1969	1.35	1.32
1970	1.43	1.40

MODAL COMPETITION

What has been the effect of these traffic trends insofar as the standing of the railroads with its competitors is concerned? Table 1 presented earlier offers an answer to this question. It shows that since 1967 the industry's share of the transport market has dropped over two percentage points. In short, despite a ten year increase of 35 per cent in ton-miles, the railroads have seen their share of the total transportation market slip from 44 to just over 40 per cent. It is this anomaly which lies at the core of the industry's traffic problems, pointing up the interplay between pricing, service and utilization variables. To 1967 rail rates (as reflected in yield per ton-mile) fell, traffic increased rapidly, the rail share of intercity freight traffic remained nearly constant, and railroad efficiency (as reflected in revenue per unit of investment) improved. After 1967 there was deterioration in each of these measures.

Much of the explanation for this "squeeze" on the railroads rests with the carriers' inability to penetrate more substantially the manufactured goods market. Available commodity statistics convincingly demonstrate that the railroads continue preponderantly to haul low-rated, bulk traffic and that there has been little change in this in recent years. The matter can be simply seen by examining two separate groups of commodities both of which account for about one-fifth of total rail freight revenue. The following table, which averages statistics for the years 1964–1968, tells the story: the low-rated bulk commodities make up nearly half of originated rail tonnage, whereas the higher yield finished goods total to less than a tenth of such tonnage.

COMMODITY GROUPS CONTRIBUTING 20 PERCENT OF REVENUE

[Share of originated tonnage]

Commodity:	*Percent*
Coal	26.3
Stone, minerals	12.5
Metallic ores	8.3
Total	47.1
Transportation equipment	1.8
Pulp, paper	2.7
Electrical equipment	.3
Machinery	.5
Metal products	.8
Petroleum and coal products	2.0
Total	8.1

Comparison of the Census of Transportation for 1963 and 1967 reveals that the railroads have failed to improve their position with respect to the movement of higher valued commodities; indeed the rail share of intercity ton-miles for 24 manufactured commodities fell about one percentage point. It is reasonable to assume that were it not for the intensified use of "piggyback" movements,[29] the rail share would have dropped more. (To the extent that TOFC has merely diverted shippers from rail carload movements to rail piggyback, the railroads may have suffered from the substitution of some net lower-tariff shipments.) What is clear, though, is that even with greater TOFC carloadings, the railroads have failed to make any substantial inroads on the movement of higher yielding commodities. One key reason is the railroads' near total abdication of LCL and other small shipment traffic to the trucks. Growing rapidly in volume, such traffic now makes up over 95 per cent of all shipments that move by for-hire motor carrier and has contributed materially to the doubling of Class I and II truck revenue that took place between 1960 and 1969.

Looking to the future, there is a good reason to believe that the fate of the railroads will in large measure be determined by the extent to which the industry can gain a greater share of the manufactured goods market. If the railroads are to improve their financial posture and keep up with the rapidly changing character of the economy, more aggressive initiatives aimed at these kinds of markets are called for. Should the industry continue to depend so heavily on the lower valued bulk commodities, it runs the risk of confining itself to traffic that not only yields comparatively little in terms of revenue, but, as noted earlier, possesses less potential for traffic growth. In contrast, manufactured goods offer the railroads the twin prospects of greater returns and growing markets.

Can the industry move more of this kind of traffic? The answer ultimately reduces to the matter of rail-motor carrier competition since almost all truck traffic is concentrated in the high yield sectors. As Table 34 shows, the railroads now move less than 30 per cent by weight of manufactured goods traffic, while the trucks enjoy about two-thirds of this market. What is particularly striking, however, is that contrary to popular impression, about a third of all truck shipments move 500 miles or more, a distance on which for most shipments (with weight and cube considered), comparative costs should make rail movement superior. The example of how the railroads regained from trucks a significant share of the automobile market stands as evidence that high-rated traffic can be held by or attracted to the railroads. The fact, however, is that for most manufactured goods the rail share of longer-haul shipments is decidedly below the apparent potential.

[29] See Appendix, Table A–39.

TABLE 34.—SHIPMENTS SUBJECT TO TRUCK AND RAIL COMPETITION

Shipper class	Commodity	Total tons (thousands)	Percentage distribution		
			Rail	For-hire truck	Private truck
011	Meat, fresh or frozen	16,641	28.7	32.7	37.6
012	Meat products	10,579	26.7	34.3	37.6
013	Dairy products	11,455	35.5	30.3	34.0
021	Canned fruits and vegetables	17,229	51.3	23.6	22.4
022	Canned specialties and frozen food	14,826	43.3	40.5	15.3
023	Grain mill products and sugar	85,724	59.6	12.5	26.8
024	Miscellaneous food preparations	37,592	55.1	23.8	12.4
031	Candy and confectionery	4,931	22.4	73.4	3.2
032	Alcoholic beverages	23,995	40.4	23.3	35.5
033	Soft drinks and flavorings	9,587	4.3	19.6	74.3
034	Tobacco products	1,814	52.1	46.4	.9
041	Broadwoven fabrics	5,517	6.9	67.9	24.2
042	Other basic textiles	7,695	11.0	53.9	34.2
043	Footwear, except rubber	409	3.9	61.2	27.0
044	Leather and leather products	874	9.2	59.6	27.8
051	Men's, youth's, and boy's clothing	862	2.8	70.9	16.0
052	Women's and girl's clothing	757	9.0	61.0	14.1
053	Knitted clothing	1,046	9.7	67.8	16.9
054	Millinery, fur goods, and miscellaneous clothing	1,849	17.3	60.2	19.5
061	Pulp and paper	25,370	71.9	22.7	3.0
062	Building paper and boards	18,951	68.5	17.4	12.1
063	Paperboard products, excluding boxes and cartons	13,085	45.7	39.0	14.6
064	Containers, boxes and similar products	14,271	17.8	39.7	41.1
071	Basic inorganic chemicals	29,247	54.2	23.4	10.0
072	Miscellaneous industrial chemicals	56,115	55.2	22.4	8.8
073	Plastic materials and synthetic resins and fibers	12,257	35.8	51.6	11.0
081	Drugs	1,917	30.2	60.0	6.2
082	Soap, detergents, toilet preparations	10,372	23.8	61.5	13.4
083	Paint and applied products	5,061	10.2	74.1	15.2
084	Gum and wood chemicals, agricultural chemicals	43,819	43.0	23.0	21.2
091	Products of petroleum refining	404,721	5.3	9.8	4.0
092	Paving and roofing materials	12,939	23.1	44.2	32.1
101	Tires and inner tubes	4,143	45.3	47.9	6.1
102	Rubber footwear	295	5.6	77.7	6.1
103	Miscellaneous rubber products	2,605	9.6	77.3	10.3
104	Miscellaneous plastic products	3,014	13.9	71.8	12.6
112	Lumber and dimension stock	38 714	51.7	11.5	28.8
113	Millwork, veneer, plywood, and prefabricated wood products	12,227	71.1	12.4	16.2
114	Wooden containers and miscellaneous wood products	10,918	39.4	21.6	38.4
121	Household and office furniture	4,482	26.4	40.5	30.8
122	Other furniture and fixtures	1,830	14.7	65.9	18.4
123	Jewelry, toys, amusement and sporting goods	760	29.6	60.0	2.0
124	Musical instruments, pens, pencils, and miscellaneous manufactured goods	1,640	6.8	70.3	18.6
131	Flat glass	1,388	50.0	41.4	8.6
132	Glass containers	12,751	16.3	70.2	13.4
133	Structural clay products	23,680	33.5	33.4	32.1
134	Concrete, gypsum and plaster	31,273	41.5	36.3	21.3
135	Hydraulic cement, cut stone, abrasives, asbestos	75,221	37.2	47.6	11.8
141	Steel works and rolling mill products	113,521	52.9	35.9	3.6
142	Iron and steel castings	12,556	31.5	49.8	17.6
143	Miscellaneous primary metal products	2,898	29.5	55.6	14.8
151	Nonferrous metals primary smelter products	11,156	70.4	15.7	10.8
152	Nonferrous metal basic shapes	10,167	29.0	56.1	13.8
153	Nonferrous metal castings	1,453	18.1	66.4	15.2
161	Cutlery, tools and hardware	1,925	20.6	65.7	11.4
162	Plumbing fixtures and heating apparatus	1,686	18.3	64.8	15.8
163	Fabricated structural metal products	13,057	23.9	38.9	34.4
171	Metal cans	5,067	29.0	44.3	24.8
172	Bolts, nuts, screws, rivets	1,842	5.8	82.1	7.5
173	Metal stampings and plating	6,320	19.8	58.5	19.5
174	Miscellaneous fabricated wire and metal products	5,179	21.2	55.9	22.0
181	Metalworking machinery	1,908	10.0	59.1	14.4
182	Special industry machinery	1,447	12.5	73.0	13.2
183	General industrial machinery and equipment	3,348	23.3	66.5	8.3
191	Engines and turbines	1,237	28.1	62.3	8.1
192	Farm machinery and equipment	4,199	32.3	42.0	24.6
193	Construction mining, and materials handling equipment	6,386	40.1	49.3	9.4
194	Office and service industry machinery	3,520	23.1	65.3	8.2
195	Miscellaneous machinery and parts, exc. electrical	478	1.3	58.1	37.8
201	Radio, TV and phonographs and records	1,288	21.6	64.7	10.6
202	Communication equipment	653	26.2	65.4	1.2
203	Electronic components and accessories	573	14.6	59.8	15.9
211	Electrical transmission and distribution equipment	1,636	23.5	64.5	10.5
212	Electrical industrial apparatus	2,159	22.7	57.0	16.2
213	Household appliances	4,077	65.3	30.3	3.2
214	Electrical lighting and wiring equipment	2,225	21.9	64.1	11.6
215	Miscellaneous electrical machinery	2,018	9.6	60.6	26.8
221	Truck and bus bodies	896	57.9	26.4	14.3
222	Motor vehicles and parts	35,629	57.5	37.2	4.7
231	Aircraft and parts	1,232	26.9	62.3	6.5
232	Ships and boats	605	21.7	44.7	25.5
233	Other transportation equipment	4,322	52.5	29.1	18.0
242	Measuring and controlling instruments	354	3.9	81.3	4.6
243	Medical instruments and supplies	524	5.3	71.4	17.1
244	Watches, clocks and photographic equipment and supplies	564	27.3	66.7	3.2

Source: U.S. Bureau of the Census, Census of Transportation, 1967 Commodity Transportation Survey: Shipper Series.

To further participate in high yield traffic will require policies that are highly sensitive not just to pricing, but to speedier delivery, and sharply reduced loss and damage claims as well. Although a finer tuning of rates is important, it would probably be a mistake to regard lower tariffs as the only barrier to be surmounted. Delays in and the increasing uncertainty of delivery also contribute to shipper avoidance of rail service, with terminal and classification yards representing notable bottlenecks. With freight transportation consumers increasingly viewing the intercity movement of merchandise as only one part of a complete distribution system, these delays and attendant costs assume growing significance. Especially for higher-valued commodities these factors can assume more importance than the tariff itself. They help explain why some shippers will pay a premium to ship via truck rather than rail.

Along with the problem of delivery schedules, the railroads must also develop solutions to the rising rate of loss and damage. Shippers now using rail are becoming increasingly concerned about these claims, but perhaps equally as critical, other shippers may well be avoiding rail service because of the poor reputation the carriers are gaining. Calculations reveal that over $224 million was spent by the railroads for loss and damage in 1970—an amount equaling 46 per cent of net railway operating income.

CONCLUSION

As has been true for many years and as is likely to be the case for many years to come, the railroads are heavily oriented to the transportation of bulk commodities. On this traffic yields are relatively low (though not necessarily unprofitable, at least in the sense of coverage of marginal costs) and the rate of growth is likely to continue to be generally slow. If the railroads are to expand and increase their share of intercity transportation they must exploit the potential that lies in the movement of manufactured goods, notably including shipments by TOFC—trailer on flat car—and container. The economies of the situation make this feasible for many types of movements, taking into account the character of the product, costs, weight, and shipment distance. If, though, the potential is to be converted into reality it will require better service (meaning improved utilization of equipment, notably freight cars), faster turnarounds, reduced terminal and handling times, and a highly flexible marketing approach that more closely relates rates and service to competitive modes of transportation. Among other things this demands a complementary public policy, one that is conducive to innovation.

RAIL TRANSPORTATION AND PUBLIC POLICY

Public policy for the nation's surface transportation system is a composite of many elements, assembled piecemeal fashion over the years into a patchquilt of highly diverse ingredients. Among the modes there are great differences in the way they are treated in terms of regulation, financial aid, and other key economic and institutional variables. For the railroads these differences have presented major problems, from an intermodal as well as intramodal respect. Many of the crucial issues deal with regulation (its character, administration, scope of coverage), but government policies generally, especially in the form of subsidized infrastructure investment, have also been significant in their impact on the railroads.

The details are important, but even more so is the economic and attitudinal environment which these divergent government policies have produced over the years. In speaking of public policy as it pertains to the railroads we are dealing with forces that have been at work for a long time and that have conditioned management thinking as well as every aspect of their operations. There is an enormous investment in the transport status quo and changes thus take place very slowly, a fact that is well to keep in mind in examining the topic and in thinking about modifications in approach. One lesson for the railroads is that as much emphasis must be placed on working more effectively within what is essentially the existing legal framework as on changing it in some fundamental way.

RATE REGULATION

Of the many ways in which public policy affects the railroads, rate regulation has been the most influential. A review of existing regulatory policies pertinent to railroad rates reveals these highlights—

* Despite Congressional efforts in 1958 to expand the zone of rate-making freedom for the railroads, the applicable cost and tariff standards remain unclear as they pertain to intermodal competition.
* Value-of-service rate-making principles still seriously distort the rail rate structure. On the basis of available cost evidence, many commodities move at rates substantially below or above cost, raising the distinct possibility that by selectively adjusting rates, up in some cases and down in others, the railroads could increase their traffic and earnings.
* Although value-of-service principles continue to dominate railroad pricing, cost elements influence ICC decisions and railroad rate initiatives. Unfortunately, however, the cost criteria used by the Commission are highly misleading and of severely limited economic utility. Without better, more precise cost data, no one—the Commission, railroads, or shippers—can determine the economic validity or consequences of changes in individual rates.
* On the whole, the existing rate-making regulatory process is unduly slow, cumbersome, inflexible, and hostile to marketing innovation by the railroads. One by-product is that the railroads have placed greater emphasis on general rather than selective rate adjustments as a way of attempting to increase revenues. As shown by the experience of the late 1960's, such increases can be disadvantageous, suppressing traffic growth, diverting traffic to other modes, and hurting rather than helping earnings.

Railroad rate regulation is a subject of inexhaustible interest to academic, professional, and transport specialists. A review of the recent literature, however, reveals little that has not been said many times before. The billions—perhaps a trillion—railroad freight tariffs on file manifest the same basic

features as they have for years. Rates continue principally to reflect value-of-service elements, as modified by shipper bargaining power, rather than relevant costs. The most recent ICC study of rail traffic, for example, reveals that 86 per cent moves at less than 98 or more than 103 per cent of fully allocated cost, with about 18 per cent falling in the former category and 68 per cent in the latter. This distribution reflects the regulatory supposition that higher-valued traffic is inelastic to rates and that if it were to bear lower rates the railroads would lose revenue and hence be unable to move lower-valued commodities (primarily agricultural and mine products) at rates less than their full costs.

The nature of the industry rate structure has produced many important consequences, whose ramifications range far beyond their impact on the railroads. Economic analyses indicate that rail shipment costs for many manufactured commodities, especially on medium-to-long-haul movements, are lower than by truck. However, many existing rates are sufficiently higher than the costs of truck transport so that taking into account the service (and implicit cost) advantages of truck movement (speed, dependability, shipment size etc.), much traffic goes by highway that could more efficiently move by rail. The railroads thus lose traffic and overall transportation costs for the nation are artificially raised.

In the case of low-valued bulk commodities and agricultural products, existing regulatory policies make it difficult to achieve a closer conformance of rates and costs. Even acknowledging the arbitrariness of present procedures to determine costs it is no doubt indicative of the situation that some 18 per cent of rail traffic moves at rates that yield less than 98 per cent of fully allocated cost. Products like sand, gravel, crushed stone and pulpwood as well as agricultural commodities like fresh fruits, fresh vegetables, and sugar beets are moved at rates that generally fail even to cover ICC-estimated variable costs. The problem is aggravated at the state level, with intrastate rates often being lower than interstate rates. Although some of this low or no-yield traffic may cover true marginal costs, much no doubt is below-cost and represents a drain on railroad earnings.

The obvious prospect of adjusting rail rates to correspond more closely to costs raises the complex and highly controversial question of intermodal rate competition. In 1958, after years of dispute, Congress revised the rule of rate making, declaring that "rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy." While the latter clause introduces considerable ambiguity into the "rule" because of the uncertainty inherent in the 1940 statement of policy, the Supreme Court was later to say that the ICC was wrong in concluding that the 1958 amendment brought about "no fundamental change in the law." [30]

It is still not clear, however, exactly what "change" was made and, in particular, how it should be reflected in specific cases. The courts have said that one mode's rate is not to be held up "simply" to protect the traffic of a competing regulated mode. Beyond that there is great uncertainty as to the rules governing intermodal rate competition. In the 1968 *Ingot Molds* case [31] the Supreme Court set aside a District Court decision that negated a Commission ruling cancelling a proposed rail rate that, though compensatory (above long term out-of-pocket costs), was both less than rail fully-distributed costs and competing barge-truck fully-distributed costs. The railroads had argued that the appropriate standard was out-of-pocket costs, but this was rejected by the Commission. In upholding the ICC on this point the Supreme Court seemed not to be saying that any particular cost standard must be used but only that the 1958 amendment did not require the use of out-of-pocket costs.[32] In the wake of *Ingot Molds* the Commission initiated a rule-making proceeding to consider what cost standards should be used in cases of intermodal regulated competition. For all practical purposes, then, the 1958 Act appears to have had far less impact on intermodal rate competition than many thought it would have. It did not succeed in providing the railroads with a new, clearly-defined zone of rate-making freedom.

[30] ICC v. New York, New Haven & Hartford R.R., 372 U.S. 744 (1963).
[31] American Commercial Lines v. L&N Railroad Co., 392 U.S. 571 (1968).
[32] *Id.* at 591–92.

Pervading the entire subject of rail rates is the question of costs, which remain a significant point of reference for rail initiatives and regulatory action. For many years the Commission has estimated rail "variable" and "fully allocated" costs. Its techniques for doing so have been the subject of a great deal of attention. The nearly-unanimous opinion of independent analysts is that the Commission's cost estimation procedures are so seriously deficient that the results they produce are virtually useless.[33] The principal objection is to the way in which variable costs are determined. To make this calculation the ICC uses a so-called per cent variable, treating 80 per cent of operating expenses as variable. As an approximation of marginal costs this has grave weaknesses. Among other things it assumes that the percentage variable remains the same for all railroads. In economic fact this will rarely be true. Operating circumstances, traffic volume, and expense components will range widely and in any given case, as a result, marginal costs can be significantly higher or lower than 80 per cent. The Commission's cost determinations are now simply so aggregative that they are of dubious value, yet they remain the yardstick by which rates are supposed to be tested. This introduces such an extreme degree of arbitrariness into rate regulation that it renders the entire process highly artificial.

Subject to even less empirical examination is the matter of elasticity of demand to rates. The implicit regulatory assumption is that traffic is highly inelastic to rates, so that a tariff reduction is likely to produce no increase in demand and thus result in a decline in revenue. The evidence, however, suggests that much traffic is in fact highly sensitive to rates and that a rate reduction can lead to increased revenue because of the additional traffic it generates. Nonetheless the belief that traffic is insensitive to rates is firmly held by the Commission and even by some railroads. As a consequence, with rail rates often equal to or only slightly below truck rates (even though rail costs may be lower), significant amounts of manufactured goods traffic moves by truck because of superior truck service and resulting lower total distribution costs.

Another pertinent characteristic in this area is a regulatory attitude reflecting a philosophical disinclination to experiment, a hesitancy to act without a sure and comprehensive awareness of all the facts and likely consequences, and a reluctance to proceed on an interim basis with subsequent reassessment in the light of actual experience. These are hardly objectionable qualities per se, but pursued relentlessly—as they have been for many years—they can imprison the regulators and those they supervise in a climate that is hostile to innovation and unresponsive to rapidly changing technological and economic events.

While regulation thus plays a role in explaining the considerable rigidity that characterizes the rail rate structure, railroad marketing perspectives also are a key ingredient. On the whole, industry attitudes, shored up by the consensus-seeking compulsion of the rate bureaus, have not been sympathetic to the aggressive tailoring of rates and service to potential market opportunities. Although the auto rack car experience shows that substantial traffic can be regained from other modes, the railroads in recent years have placed more emphasis on across-the-broad rate increases rather than on selective rate adjustments calculated to improve net earnings. Cases such as the *Big John* proceeding and *Rent-a-Train* are by now well celebrated, but they remain exceptions to a more general pattern of passive ratemaking. While across-the-board increases advocated by the industry are handled relatively speedily by the Commission, it displays a general lack of enthusiasm—often reflected in lengthy delays—for innovative rate initiatives proposed by individual carriers.

What must be stressed is that despite the deficiencies of ICC rate regulation, the railroads do now have considerable room within which to adjust their prices. Most rail rates, it must be remembered, are above fully-distributed costs and it is fairly well established that as long as rates cover fully-distributed costs there is usually little basis for objection from competing regulated modes (and practically none from competing unregulated carriers). In most respects, therefore, the railroads now have considerable discretion to reduce rates, par-

[33] A pertinent court assessment of the Commission's cost definitions is in New York, New Haven & Hartford R.R., 199 F. Supp. 635, 647–48 (D. Conn. 1961). For an economic valuation see John R. Meyer et al., *The Economics of Competition in the Transportation Industries* (1959), Appendix A. The comments of the Supreme Court in the *Ingot Molds* case, supra, are also in point. See 392 U.S. 571, n. 16 at 586–89.

ticularly on higher-valued commodities. Admittedly the process of rate adjustment can be long and tedious, especially where there are applications for suspension. Nonetheless the number of suspension cases must be kept in perspective. In fiscal year 1971 only 392 rail rate proposals were considered for suspension and only half of these were actually suspended. Industry sources informally concede that they have had good success in putting into effect the great bulk of rates they have proposed. Part of the problem, therefore, turns into a question of the relatively low level of specific rate initiatives made by the railroads for purposes of traffic generation. Overall too much emphasis has been placed on general upward rate increases, of the sort sought by the railroads in the late 1960's and early 1970's (Ex Parte proceedings 256, 259, 262, and 265), and too little on tailored upward and downward adjustments as a way of improving earnings.

MERGERS

In recent years, particularly beginning about 1957, a great wave of mergers has swept through the railroad industry, involving virtually every carrier and leading to substantial structural realignments. Since mergers have been viewed as a way of increasing railroad efficiency, primarily through consolidation of plant, and since they have been so pervasive in railroading, they warrant careful examination.

The beginning point is the law itself. Under Section 5(2) of the Interstate Commerce Act, as amended in 1940, mergers or consolidations between railroads (or the acquisition of control of a railroad by one or more other railroads) must be approved by the Commission. (By contrast, as will be noted later, the Commission's power to deal with railroad holding companies is considerably more limited.) Only if the ICC finds that the merger (or other related transaction) will be "consistent with the public interest" may it be carried out and then only upon such "terms and conditions" and with such modifications as the Commission finds "just and reasonable."

In making the requisite statutory determinations the Commission is directed by Section 5(2)(c) to "give weight to the following considerations, among others: (1) the effect of the proposed transaction upon adequate transportation service to the public; (2) the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved in the proposed transaction; (3) the total fixed charges resulting from the proposed transaction; and (4) the interest of the carrier employees affected." As to what weight is to be assigned to each of these factors, how they are to be applied, and what other factors are to be considered, the law leaves vast discretion to the Commission.

The courts, however, have effectively added a fifth element that must be taken into account, namely the antitrust laws. Under section 5(a) mergers and other transactions that are approved by the Commission have immunity from the antitrust laws. In a string of cases, running back to the *McLean* decision in 1944 [34] and continuing through major recent rail merger cases (such as *Seaboard Coast Line* [35] and *Northern Lines*[36]), the Supreme Court has acknowledged that while the Commission has the authority to approve mergers that might lessen competition and otherwise violate the antitrust laws (specifically Section 7 of the Clayton Act, as amended, and the Sherman Act), it must specifically consider the competitive consequences of a proposed merger and determine that any likely adverse competitive results are outweighed by probable transportation and public interest benefits. While the courts have acceded to the Commission's expertise in making such a judgment, it is also clear that the evaluation of the antitrust issues cannot be merely pro forma and that a mere declaration that the benefits outweigh the competitive effects will not suffice.

As amended in 1940, Part I of the Interstate Commerce Act significantly changed those provisions of the 1920 Act that applied to railroad consolidations. Under the 1920 Act the Commission was instructed to prepare a plan for consolidation of the railroads, the weak as well as the strong, into a limited number of systems of approximately equal strength. Only such combinations that conformed to the plan were to be approved. This approach proved unwork-

[34] McLean Truck Co. v. United States, 321 U.S. 67 (1944).
[35] 382 U.S. 154 (1965).
[36] 396 U.S. 491 (1970).

able and with the passage of the 1940 Act, the plan requirement was repealed. Congress, however, was not inattentive to the effects of a proposed merger on other railroads and, in fact, even left the ICC with the authority to require the inclusion of other railroads if requested and if such inclusion was consistent with the public interest.

From the passage of the 1940 Act until well into the 1950's railroad mergers were few in number and limited in economic significance. Beginning, however, with the filing of the Virginia-N&W merger in 1959 the flood gates opened and thereafter, until the collapse of the merged Penn Central, dozens of major merger applications were filed with the Commission. Between 1957 and 1970 all of the 25 largest railroads were involved in at least one merger, usually in several (Table 35). Every region has been affected, but it is in the East where the impact so far has been the greatest. Through a process of merger the entire Eastern railroad picture has been radically transformed.

TABLE 35.—INVOLVEMENT OF THE LARGEST RAILROADS IN THE CURRENT MERGER WAVE

Railroad	Consummated or approved mergers	Pending mergers
Pennsylvania	Pa.–L.V.; Penn Central	
Southern Pacific	SP–Tex. & New Orleans	UP–RI.
Santa Fe	AT&SF–Toledo, Peoria, & Western	UP–RI; MP–SF.
New York Central	Penn Central	
N & W	N&W–VGN; N&W–NKP–Wab	
Union Pacific	UP–Spokane International	UP–RI.
Seaboard Coast Lines	SAL–ACL	
B & O	C&O–B&O	
C & O	C&O–B&O	
Southern	Sou–C of Ga; Sou–C of Ga. & Fla	
Missouri Pacific	MP–C&EI (with partial divestiture)	MP–AT&SF.
Illinois Central	IC–GM&O	
L & N	L&N–NC&SL; (Monon.)	L&N–IC.
Burlington	Northern Lines	
North Western	CNW–CSPM&O; CNW–M&SL; CNW–L&M; CNW–CGW	CNW–RI; CNW–Milw.
Milwaukee		CNW–Milw.
Great Northern	Northern Lines	
Rock Island		UP–RI; CNW–RI.
Erie–Lackawanna	Erie–Delaware, Lackawanna & Western (Dereco)	
Northern Pacific	Northern Lines	
New Haven	Penn Central	
Cotton Belt		SP/SLSW–Alton & Sou.
Gulf, Mobile & Ohio	IC–GM&O	

Looked at as a whole the railroad merger proceedings of the last 15 years display these principal features—

* In handling merger applications the ICC has proceeded on a strict case-by-case approach, generally failing explicitly to consider the impact of a pending merger on other railroads. This has led to a domino effect, particularly in the East, with one merger inspiring and often forming the justification for other follow-on mergers.
* The Commission role in merger proceedings has been almost entirely passive, with nearly complete dependence on the parties to come forward with the evidence and analysis. There has been no meaningful effort to develop the facts, to test the claims advanced by proponents, or to assess rigorously the merger's contribution to improved service.
* Justification of proposed mergers has rested almost exclusively on claimed cost savings that would result from consolidation. Little emphasis has been placed on a factual showing of the benefits in better service likely to result. Where mergers have been approved the evidence shows that the alleged cost savings have generally failed to materialize or have been much smaller than were anticipated.
* Mergers have substantially reduced railroad competition in point-to-point markets. Of 57 point-to-point markets with three or more rail carriers in 1955, after the Penn Central and Northern Lines mergers there were only 36—a decline of 37 per cent.
* Merger proceedings have been excruciatingly slow. Three years is "quick response" and as much as a decade can pass before final Commission action.
* There has been grossly inadequate regulatory follow-up to assess the actual performance of large-scale mergers in terms of conformance with representations made during the proceedings, gains in efficiency, and qualitative performance.

The interlocking pattern of rail mergers, with one spawning another in a snowballing process, is best illustrated by developments in the East. The Eastern railroad story began in 1958 when the ICC approved the merger between the Norfolk & Western and the Virginian, two financially strong railroads heavily engaged in the movement of coal. Their merger promised cost savings; and, looked at as an isolated event, appeared to be of no great significance for the structure of rail transportation. Innocent though it seemed at the time to be. that merger unleashed a wave of mergers that did not expire until the entire Eastern rail system was completely restructured and the Penn Central, the great house of cards, had been created. The Virginian-N&W merger ended the New York Central's access to the Pocahontas coal territory. With its valuable coal traffic threatened, the New York Central sought protection in a merger with the B&O. Pressed to consider merger, the B&O decided to merge instead in a two-way arrangement with the C&O. When the C&O and B&O merged, the N&W was threatened because it gave the C&O access to St. Louis and to transcontinental traffic. To counter this move the N&W merged with the Nickel Plate and the Wabash railroads (the latter through a lease arrangement), an affiliation that, in a sense, "one-upped" the C&O–B&O since it gave the N&W access not only to St. Louis but to Chicago, Kansas City and Omaha as well. These moves placed the NYC in even greater jeopardy. With what it regarded as its more desirable partners having already merged, the NYC finally agreed to join with the Pennsylvania in their ill-fated union. When the Penn Central merger was authorized in 1968, only ten years had passed since the Virginian-N&W merger but the entire Eastern railroad industry had been restructured.

The Commission is now faced with a number of mergers in the West and the as yet unresolved question is whether it will consider them in the same piecemeal fashion as it did in the East or whether it will examine comprehensively their interrelationships and overall system and competitive consequences. Now that the Northern Lines merger has been approved, pending cases principally affect service along the central western arteries, notably those linking Chicago and points along the Missouri River. In the area between the Rockies and the Mississippi there is undisputed excess capacity, which carries with it the temptation to consolidate independent carriers into larger systems as a means of eliminating redundancy and gaining greater line-haul density. The more basic question concerns the makeup of the surviving systems, the impact on competition, and the realism of claimed cost savings and alleged gains in operating efficiency. The Eastern rail merger experience dramatically underscores the importance of looking at the various proposed mergers as a whole, viewing their interrelationships and assessing their downstream impact on other carriers (including those not immediately involved in pending applications). If the lessons of the Eastern merger are drawn upon, they would urge considerable caution in the West as to the acceptance of claimed cost savings and service improvements, point up the sizable managerial problems encountered in consolidating different carriers, and underscore the value of maintaining competition between surviving systems in and as related to the affected region.

Claimed cost savings have formed the backbone of the case for proposed rail mergers. Adding up the individual items yields total annual cost savings approximating half a billion dollars—or about five per cent of aggregate current operating expenses for the Class I railroads. The amounts have varied from case to case but often have been large. In the Seaboard Coast Line merger savings of almost $40 million were forecast, of over $40 million in the Northern Lines case, and of $27 million in the N&W–Nickel Plate-Wabash case. The largest claims came in Penn Central, with projected cost savings of more than $80 million. Suffice it to say that they did not materialize, but the size of the gap between promise and reality in Penn Central, though dramatic, is not unique.

In the preponderance of the mergers that have been approved since 1959 the record reveals that cost savings forecasts have typically been overblown, that where some savings have resulted they have been exceedingly modest, that savings are far more difficult to realize and require far longer than is anticipated, and that merger can lead to rising rather than falling costs. Finally, from the standpoints of service and performance there is no respectable empirical evi-

dence to show that mergers have resulted in any general improvement. To the contrary: by bringing together two or more disparate operations, merger often leads to confusion and a deterioration in service which, when and if corrected (which it was not in Penn Central), bring the system back to about the same efficiency level the separate roads had achieved prior to consolidation.

The available evidence, as borne out by the experience of the last 15 years, simply does not establish that mergers are a generally useful way of increasing efficiency, eliminating excess capacity, or improving rail service. By and large they are more likely to be harmful than beneficial. In particular cases they may hold out the promise of achieving net benefits that could not be realized in any other way, but experience strongly suggests that mergers should be viewed with considerable suspicion and that proponents should bear a far heavier burden to establish affirmatively the benefits of consolidation and to demonstrate that the anticipated gains cannot otherwise be achieved (such as through abandonments or the sharing of common facilities that do not involve outright merger).

HOLDING COMPANIES AND RAILROAD DIVERSIFICATION

During the 1960's several of the country's railroads transmuted themselves into conglomerate corporate enterprises with the aim of diversifying into non-rail areas of investment activity. By the end of 1970 some 14 companies had taken this step, with others planning to do so (Table 36). Included were railroads in relatively strong financial condition (e.g., the Union Pacific) as well as less prosperous lines. Railroad holding companies now account for over half the assets of the railroad industry. From a legal standpoint these reorganizations took several basic forms, each leading to the creation of a non-rail investment vehicle. In one variation the railroad formed a parent holding company, with its stockholders swapping their railroad shares for equivalent interests in the new holding company. This was the device used by Northwest Industries and the Union Pacific, for example. In another variation the railroad formed a downstream non-rail subsidiary, whose stock was held by the rail parent. This approach was followed by Penn Central with its organization of the Pennsylvania Company. In some cases railroad assets have been transferred, sometimes as dividends, either at book or at estimated market value.

TABLE 36.—CONGLOMERATE HOLDING COMPANIES AND MAJOR RAILROAD COMPANIES CONTROLLED AS OF DEC. 31, 1970, WITH SELECTED BALANCE SHEET DATA

	Working capital [1]	Working capital [2]	Debt	Equity
Northwest Industries, Inc. (consolidated) [3]	$229.5	$185.9	$147.3	$389.0
Chicago & North Western Ry.[4]	[5] 2.2	[5] 20.9	282.8	422.5
Penn Central Co. (consolidated) [4]				
Pennsylvania Co. [4]	[5] 40.8	[5] 40.8	103.5	345.2
Penn Central Transportation Co.[4]	109.9	25.2	1,901.8	1,500.4
Illinois Central Ind., Inc. (consolidated) [3]	120.0	109.4	317.4	705.0
Illinois Central RR.[4]	37.4	26.7	237.1	611.1
Rio Grande Ind., Inc. (consolidated) [3]	22.2	18.1	84.3	159.2
Denver & Rio Grande Western RR. Co.[4]	27.1	23.0	80.6	182.8
Union Pacific Corp., (consolidated) [3]	70.0	23.5	634.1	1,416.7
Union Paicfic R.R. Co.[4]	105.7	75.3	470.7	1,805.6
Sante Fe Industries, Inc. (consolidated) [3]	48.7	6.6	542.6	1,298.3
Atchison, Topeka & Santa Fe Ry. Co.[4]	55.7	16.2	335.1	1,419.1
Kansas City Southern Ind., Inc. (consolidated) [3]	5.9	.7	107.1	138.1
Kansas City Southern Ry. Co.[4]	9.6	5.9	91.6	147.8
Southern Pacific Co. (consolidated) [3]	19.5	[5] 2.0	800.9	1,596.6
Southern Pacific Transportation Co.[4]	48.5	29.5	789.0	1,483.8
Katy Industries, Inc. (consolidated) [3]	21.1	1.7	21.3	33.6
Missouri-Kansas-Texas R.R. Co.[4]	[5] 3.6	[5] 6.7	108.2	1.9
Mississippi River Corp. (consolidated) [3]	2.1	[5] 4.0	92.2	106.6
Missouri Pacific System [3]	21.1	7.4	719.2	510.0
Missouri Pacific R.R. Co.[4]	1.3	[5] 8.9	561.3	383.7
Seaboard Coast Line Ind. Inc. (consolidated) [3]	[5] 3.7	[5] 31.3	390.0	668.8
Seaboard Coast Line R.R. Co.[4]	30.1	3.3	377.8	780.0
Boston & Maine Ind., Inc				
Boston & Maine Corp.[4]	2.2	[5] 1.5	71.8	84.9
Amoskeag Co				
Bangor & Aroostook R.R. Co.[4]	[5] .4	.9	25.8	35.2
Western Pacific Ind. Inc				[5] .9
Western Pacific R.R. Co [4]	[5] 2.5	[5] 6.5	60.8	120.9

[1] Including materials and supplies.
[2] Excluding materials and supplies.
[3] From annual stockholder report.
[4] From Form A report to ICC.
[5] Deficit.

Source: ICC.

Form aside, the principal objective underlying these moves has been a desire to simplify diversification into non-rail areas and to permit fuller exploitation of railroad assets (such as real estate, whose current market value may exceed its book value). Common is a belief that such investment moves will improve earnings, either because the railroad *qua* railroad is yielding less than could be obtained elsewhere or because the cash being generated by the railroad is in excess of its requirements. The former objective is more typical, but some of the wealthier roads may very well be in the latter category.

Once a railroad is linked with a controlled or controlling holding company its intrafamily financial transactions are effectively shielded from public or regulatory view. Under existing law, the Commission has concluded that it lacks the authority either to approve or even to require regular comprehensive reports on transactions that involve the holding company and its various affiliates. Because of this situation a great deal can take place in the financial shadows, so to speak, that is actually or prospectively detrimental to the railroad and those it serves. It is the risk of abuse, not its certainty or inevitability, that calls for far closer continuing supervision of railroad-holding company relationships than presently exists.

Where a railroad-holding company or linked firm relationship exists, the opportunities for abuse are limited only by the ingenuity of their financial managers, lawyers, and accountants. The devices are many and flexible, and they can be manipulated in a way that reduces the railroad's earnings, saps its assets, impairs its liquidity, and reduces its working capital. Through compelled cash dividend payments, loans, or the provision of equipment or services under lease, the railroad can be disadvantaged, with its financial strength and managerial independence undermined.

Whether this has taken place is a matter requiring case-by-case assessment, but experience shows that the prospect is one of more than theoretical speculation. Special Commission investigations have revealed seemingly abusive behavior or practices of a highly questionable character, including—

* Intercompany dividends paid by the railroad to its financial detriment.
* Sales of carrier real estate for the exclusive benefit of the holding company.
* Intercompany sales and transfers of railroad assets without adequate or equitable compensation.
* No reimbursement by the holding company or its affiliates for the use of railroad losses in consolidated tax returns.
* Intercompany leasing arrangements that are detrimental to the railroad,
* Advances or loans by the railroad without interest or at submarket rates of interest.
* Provision of services by a holding company or affiliate to a railroad at excessive costs.

The cumulative effect of these practices can be to siphon cash from the railroad and weaken its capacity to function as a common carrier. This need not necessarily be the case, but the evidence developed by the Commission with respect to Bangor Punta and Kansas City Southern, to cite two specific cases, shows that cash outflow from a railroad to a holding company or affiliate can exceed any benefits that may be present.

The holding company-conglomerate phenomenon can ultimately only be understood through a detailed examination of each situation. Estimates of aggregative dollar flows into and out of the industry, as expressed in Sources & Uses statements, are too gross to be of any practical value, failing to shed light on the practices that can take place within a holding company family. So rapid has been the spread of holding companies in the railroad industry and so ripe the potential for abuse, that close, continuing regulatory supervision is essential. At the minimum this calls for detailed information on intrafamily corporate transactions to be regularly submitted to the Commission for timely assessment and appropriate action.

Since the founding of the country, government has played a role in the development of transportation, providing infrastructure, subsidies, and supportive technological research. In the last century the railroads, primarily in the West, were substantial beneficiaries, but during this century, with but limited exceptions, virtually all government assistance has gone to the other modes. This uneven treatment of transportation, coupled with regulatory modal inequities (virtually all rail freight service is regulated, only some truck, and only a small fraction of barge traffic), has placed the railroads at a disadvantage. In a larger perspective of public policy this situation is but another symptom, albeit an important one, of the nation's lack of a consistent, coordinated approach to transportation.

One of the key differences in government policy to the modes is the wide disparity in the provision of infrastructure. As noted elsewhere in this report, railroad investment reflects an overwhelming emphasis on rolling stock. Capital outlays for items which relate to the functioning of rail transportation as a system (like telecommunications and computer facilities essential to the better management of the rail freight car fleet) have been seriously deficient, in significant measure because their payoff is limited if other railroads do not make similar investments. By contrast, government aid for highways, airways, and waterways has led to the creation of infrastructure systems that can be and are used by many independent private transporters, contributing markedly to the efficiency of their operations. As one illustration, the airways system, representing an investment of approximately $25 billion, embodies highly-sophisticated electronic components that no individual air carrier could have afforded since its benefits accrue to many users synergistically. The systems characteristic of non-rail public modal investment are as important a relative advantage to the other modes as the more obvious subsidy benefits they represent.

Government provision of capital, tailored to the needs of modal systems rather than the internal investment generating capacities of single carriers, has been of enormous benefit to the non-rail modes. Total government investment (Federal, State, local) in the highways, airways, and waterways now can be estimated at more than $350 billion. Only a portion of this has been recovered through user charges. State and local property taxes of rail rights-of-way, which currently amount to about $300 million annually (with the underlying valuations and applicable rates varying from jurisdiction to jurisdiction), now approach or exceed in amount total Class I rail net income.

To redress these oft-recited instances of intermodal inequity, what is needed is not piecemeal reform, but rather a comprehensive reexamination of government promotional policy. This calls for the broad leadership that can best be supplied by the Department of Transportation and the active participation of the appropriate Congressional Committees. Patching up the present system by, for instance, providing offsetting promotional aid to the railroads is at best short-lived and symptomatic in character. Small improvements can be made on a case-by-case basis but the greatest gains will come only by a fundamental reconstitution of national transportation policy.

Public policy as it affects transportation is such a heterogeneous mass that it does not readily yield to meaningful general conclusions. As one contemplates the material dealt with in this report, however, it is evident that if the railroads are to strengthen themselves financially and again become an active and growing participant in the nation's transportation, many basic changes are called for—in operations, approaches to marketing, and investment and related financial practices. Only by increasing their own efficiency and improving their productivity and reflecting the gains in well-targeted rate and service strategies, can the railroads effectively adapt these new approaches. Government policy can help, but it would be a serious mistake to think that adjustments in regulation or provision of special financial aid alone will be sufficient. The principal burden still rests with management.

The best that can be expected of government is that it act with reasonable impartiality between the modes and not impede change through regulation that fails really to promote more efficient transportation service. Even these limited goals are not now being satisfied. At present the regulatory process is unsympathetic to innovation, especially in rates and marketing concepts—the areas to which the railroads must devote far greater attention in the future than they have in the past. Steps must be taken to create a climate that is more cordial to innovation and that both creates and rewards vigorous competition in rail transportation. It deserves to be repeated, however, that the initiative still rests with management and that government policy, however changed, alone cannot restore vibrancy to the rail industry.

PART III

Analysis of Selected Issues

THE ECONOMY AND THE RAILROADS

CONTENTS

Economic Trends

There are a number of different methods of measuring business activity. The most common methods are institutional series that reflect in one way or another economic conditions. There are many such indicators and ideally a measure of general economic change should satisfy certain functions: (1) reflect the turning points in economic activity; (2) measure the amplitude of change; (3) measure the rate of economic growth or decline; and (4) have a leading tendency in relation to other series. No single series consistently contains all of these characteristics. The most comprehensive measure of aggregate economic activity is gross national product. It constitutes the total amount of final goods and services produced during the year valued at current market prices; and it also represents the expenditure side of the national accounts and includes local, state, and Federal government, businesses, and individuals. The advantage of the use of GNP for indicating business conditions is its comprehensiveness. It does have disadvantages in that it is (1) so broad in its coverage that it tends to be somewhat sluggish; (2) all of the component figures cannot readily be estimated on a monthly basis and even as prepared on a quarterly basis some detail must be sacrificed; and (3) it appears several months late and is not as current as one might desire.

The Federal Reserve Board's monthly index of industrial production is designed to measure monthly changes in the physical volume of output of manufacturing, mining, and gas and electric utilities. One should note that even though the index directly measures the output of those industries accounting for an important part of total economic activity, it excludes certain sectors of the economy, such as construction, transportation, trade service, and agriculture. Inasmuch as it is not a measure of total economic activity, it tends to exhibit wider and more frequent fluctuations than a broader based series, such as GNP.

Our national economic growth and expansion has generally been a continuing one since 1950 except for recessions in 1958 and in 1970–71. Our rate of growth, as reflected by GNP, has been approximately 5 percent a year during the last decade but dipped below that in 1970.[1] As shown in Exhibit 1,[2] GNP has risen from $355 billion in 1950 to $739 billion in 1971, based on 1958 dollars. During this 22-year period, it has more than doubled. (Numerous long range projections use 4 percent as the expected increase in the GNP.)

Exhibit 2 shows the trend of intercity ton-miles, industrial production, and GNP. less services, for the period 1960–70.[3] Placed on an index basis, this Exhibit indicates a correlation between industrial production, GNP, less services, and intercity ton-miles. During this time, the relative share of railroads in the intercity ton-mile market declined from 44.1 percent to 40.1 percent.

Exhibit 3 compares the trends in national income (based on a base year of 1967) with the revenues of five groups of carriers. As indicated in the index, railroad revenues beginning in 1959 have grown from 94.1 to 115.2 in 1970. This is a modest increase compared with the growth in revenues of motor carriers of freight which showed an increase from 63.2 to 127.3. During a period of economic expansion of our national income, 1959–70, the rail revenue ratio to national income decreased by almost 40 percent, while motor carriers of freight maintained their revenue ratio to national income.

Because of the broad nature of the gross national product as a measure of economic activity and because of the regional nature of the subject roads' operations, Exhibit 4 includes several measures which reflect economic activity, both nationally and in the New England region. The measures of economic activity

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[1] Council of Economic Advisers, *Economic Report of the President*, 1972, p. 196.
[2] Exhibits referred to in this discussion of economic trends may be found in Appendix B, p. 435.
[3] Interstate Commerce Commission, Annual Report, 1971, p. 139.

include gross national product, national industrial production as reported by the Federal Reserve Board, and New England regional production as compiled by the Federal Reserve Bank of Boston. The table shows some rather striking trends. When measured either against gross national product or industrial production for the nation as a whole, the regional production has exhibited less growth than either measure of national production. Also included in Exhibit 4 are the trends in freight revenue growth experienced by the Pennsylvania, New York Central, and the New York, New Haven and Hartford (hereinafter subject roads). These trends show a lesser rate of growth than that of the New England region. Further the rate of growth of the subject roads bears no comparison to the growth of economic activity as depicted by either the gross national product or national industrial production.

The variance between the growth rate of the New England region and that of the Penn Central roads is important in that the entire New Haven operation and significant portions of the New York Central and Pennsylvania operations are generated within the New England region. The lesser growth exhibited by the subject roads would tend to indicate a failure to participate within the New England market at a rate equal to the growth in that market.

Analysis of Traffic Patterns

Besides facing competition from the other modes of transportation, the Penn Central faces competition from other railroads in the Eastern District and from railroads in other districts. To determine the subject roads' position in the railroad system, it was necessary to examine major commodity revenue and tonnage trends. Limited insight in the matter of intra-modal competition can be developed by examining the tonnage and revenue trends of major commodities generated by the industry, the Eastern District, and subject roads. The major commodity groupings involved are "Manufactures and Miscellaneous," "Products of Agriculture," "Products of Mines," "Products of Forests," and "LCL" traffic. These data are set forth in individual exhibits.

While the exhibits do not demonstrate direct intramodal competition, the trends of each group (industry, Eastern District, and subject roads) provide some measure against which to judge generally whether the subject roads have been successful in competing for the movement of the products involved.

The first commodity grouping to be examined is "Manufactures and Miscellaneous" products, Exhibits 5 through 10. Exhibit 5 compares the amount of tonnage originated for this category grouping for Class I railroads in the United States, in the Eastern District, and for the subject roads. Exhibit 6 is an index compiled from Exhibit 5 which shows the tonnage originated for the period 1951 through 1963, and, separately, the period 1965 through 1970. It was necessary to divide the periods since the freight classification was changed extensively in 1964. Prior to that year, the classification of the statistics assembled by the ICC were grouped on a consumption basis. From 1965 to the present, these figures are based on production rather than consumption. As a result it is necessary to review each separately since the combination of the two would yield inaccurate data.

During the period 1951 through 1963, the Class I railroads remained rather stable as regards the origination of "Manufactures and Miscellaneous" tonnage. This group, in 1963, originated approximately 5 percent more tonnage than was accomplished during the base period (1957–1959). During the same time frame, the Eastern District carriers as a group experienced a slight decline in "Manufactures and Miscellaneous" tonnage originated. In 1963, the Eastern District railroads originated comparable tonnage to that generated during the base period. The performances of the Pennsylvania and the New York Central were somewhat better than the District as a whole. The New York Central originated approximately 5 percent more tonnage than in 1957–1959 and the Pennsylvania originated approximately 2.5 percent more than the base period. The New Haven experience was that of a general decline. In 1963, the New Haven was originating 21 percent less tonnage than had been originated during the base period.

The data fail to show any dramatic shifts in tonnage originated which might have been occasioned by intra-modal competition. Although the freight classification changed significantly in 1964 and a new base period (1967) was utilized, the trends for the period 1965–1970 show a decline from the levels attained during the prior period. The performance by all groups in tonnage originated for all of the railroads is significant in that this product group is a very important contributor of revenue to the railroads.

Exhibit 7 provides data comparing the tonnage terminated for "Manufactures and Miscellaneous" products during the period 1951 through 1970. From these data, an index for the base period 1957–1959 was developed and is found in Exhibit 8. With the exception of the New Haven, the indexes reflect similar trends to those indexes for traffic originated. The New Haven has experienced a lesser decline in the tonnage terminated over the base period (approximately 6 percent). The trends since 1965 show that the railroads have reached a plateau and do not indicate any shift in industry terminations.

As in the case of tonnage originated, the relative change in traffic terminated was slight for tonnage whose contribution is so important to the railroad industry generally and particularly to the subject roads.

Exhibits 9 and 10 provide a comparison of the revenues generated by the transportation of "Manufactures and Miscellaneous" products during the periods 1951–1963 and 1965–1970. Indexes of the revenues received for this product group are contained in Exhibit 10. Here again the most revealing fact is the small relative change in the revenues generated by the product group. While the Eastern District had a slight decline in revenues received in 1963 versus the base period, the two major roads involved in the merger maintained their revenue levels at rates somewhat comparable to those of the nation. The New Haven experienced an approximate 19 percent decline in revenues received for the transportation of "Manufactures and Miscellaneous" products (1963 versus 1957–1959). The data would indicate that, while the relative share of this market has not been eroded by railroad competition from other carriers since there was no significant increase with a corresponding decline for the subject roads, there appears to be a failure of railroads as a whole to be maintaining growth in this product group at a rate comparable to the market growth for this product group.

The second major product group examined was "Products of Mines," with comparative data covering tonnage originated presented in Exhibit 11. The comparison covers the period 1951 through 1963 and 1965 through 1970. From the data, indexes covering the two periods were compiled (Exhibit 12). The Exhibit shows that during the early and mid-1950's, United States railroads as a whole were experiencing a plateau as regards mine products originated. In the late 1950's, the plateau gave way to a general decline in tonnage originated. In 1963, the tonnage originated was approximately 2 percent lower than the base period 1957–1959. The experience of the Eastern District followed the experience of the nation as a whole with tonnage orginated in the Eastern District in 1963 being approximately 4 percent below the base period. The New York Central had a somewhat better experience, originating approximately 6 percent more tonnage in 1963 than in the base period. The amount of tonnage originated in this category by the Pennsylvania Railroad was somewhat less favorable than either the Eastern District or the total United States. In 1963, the railroad originated 7 percent less than the base period. The New Haven had shown, prior to 1963, a gradual decline from the late 1950's of tonnage orginated but still managed to originate tonnage at a level of 9 percent over the base period 1957–1959. The trends within the industry as shown by the indexes covering the period 1965–1970 show slight declines for the Eastern District and the subject roads. These declines are significant in that this category provides large amounts of tonnage and revenues.

A comparison of the absolute and relative changes in tonnage terminated for the subject category ("Products of Mines") is found in Exhibits 13 and 14. With the exception of the New Haven, which in 1963 terminated about 14 percent less tonnage, the subject roads, the Eastern District, and the total United States were fairly comparable, which would appear to discount any

shifts due to intramodal competition. The recent experience has seen a slight decline in tonnage terminated by the subject roads.

Exhibits 15 and 16 provide a comparison and index of revenues received for the movement of "Products of Mines." Without exception the various groups showed relative declines in revenues received for the transportation of this product category. The most notable decline in revenues received was experienced by the New Haven which received in 1963 almost 20 percent less in revenues than during the base period. Since 1965 all the groups have shown a slight improvement in revenues received.

These data show a general decline in revenues received for this traffic category which is significant since it provides substantial tonnage for the Penn Central. Also it is much less subject to intra- or intermodal competition because of the fact that it is geographically fixed and to a significant degree can be considered "captive" traffic.

The next category of traffic examined is "Products of Forests." Exhibits 17 and 18 give the absolute and relative changes in tonnage originated for the periods 1951–1963 and 1965–1970. The indexes are found in Exhibit 18. They show that during the period, tonnage originated by all Class I railroads has varied somewhat but steadied at a level fairly comparable to that experienced during the two base periods. In 1963, the tonnage originated by all Class I railroads amounted to about 1.5 percent more than during the base period. The experience of the Eastern District railroads followed fairly closely that of the Class I railroads as a whole. The New York Central originated less traffic and showed a somewhat more pronounced decline than the Eastern District and the United States as a whole. In 1963, it originated about 2.5 percent less tonnage than during the base period. The converse was the experience of the Pennsylvania railroad. The early 1960's saw a stronger relative change in tonnage originated by the Pennsylvania than either the Eastern District or the United States as a whole. The New Haven, while showing a significant increase in tonnage originated in 1963, had still come back from a decline which was more pronounced than that of either the Eastern District or the United States. The index for the period 1965–1970 shows declines in the Eastern District and for the subject roads while all railroads showed an increase in tonnage handled.

Exhibits 19 and 20 compare the tonnage of the "Products of Forests" terminated. The indexes developed in Exhibit 20 show that for the United States as a whole the relative change in tonnage terminated has been slightly upward. In the case of the Eastern District railroads, after a relative decline in the late 1950's, they have shown relative improvement in the amount of tonnage which they terminated. Neither of the major subject roads in 1963 was terminating tonnage at the level appreciably greater than that achieved during the base period. The New Haven, since the early 1960's, showed an improvement over the base period of approximately 16 percent in 1963.

Recent years have seen a slight increase in tonnage terminated by the subject roads which is somewhat less than the experience of the nation as a whole.

Exhibits 21 and 22 for "Products of Forests" show, as in the case of "Products of Mines," a slight decline in revenues received during the latter part of the period covered (1951–1963) with the exception of the New Haven which, in 1963, received over 5 percent more in revenue than during the base period. This position has improved during the last few years. Here again, the category is one that is in most cases geographically fixed and to a substantial degree could be considered captive in nature which would preclude any shifts intramodally.

The next commodity group to be examined is "LCL"—less than carload—traffic. Exhibits 23 and 24 compare the tonnage orginated by the United States railroads as a whole, the Eastern District roads, and the subject roads. The comparison covers two periods, 1951 through 1963 and 1965 through 1970. All the groups i.e., the United States as a whole, the Eastern District, and the subject roads, show a dramatic decline in the amount of "LCL" tonnage originated. With the exception of the New Haven, the subject roads demonstrated a more pronounced decline in the amount of tonnage originated than the Eastern District which, in turn, declined at a faster rate than the United States as a whole.

In 1963, the United States railroads were handling 63 percent less "LCL" traffic than during the base period but more importantly this decline occurred from 1951 wherein the Class I railroads originated over 126 percent more than during the base period. Since 1965 tonnage originated by the subject roads has leveled off.

Exhibits 25 and 26 show the absolute and relative changes respectively for "LCL" traffic terminated by the various groups mentioned. The index of railroad tonnage terminated in "LCL" traffic is comparable to the experience of tonnage originated for the same category of traffic.

Exhibits 27 and 28 compare the revenues received for the transportation of "LCL" traffic and again show a steady decline in the rate of United States, Eastern District, and subject road participation. Here again, the similarity of relative declines in participation tends to indicate a lack of any real intra-modal competition.

Data on the tonnage and revenues originated and terminated for "Products of Agriculture" are included in Exhibits 29 through 34. The relative and absolute changes in tonnage originated are found in Exhibits 29 and 30. Examination of the index shown in Exhibit 30, which is derived from the data in Exhibit 29, indicates that for the United States as a whole there has been a steady increase in the tonnage originated. This increase is somewhat less steady but fairly comparable in the Eastern District to the experience of the United States as a whole. In 1963, tonnage originated in the Eastern District was approximately 12 percent greater than the base period. The Pennsylvania Railroad showed a rather steady level of tonnage originated during the period with the exceptions of 1958 and 1959 which were recession years. In 1963, the tonnage originated on the Pennsylvania Railroad was 17 percent more than that originated during the base year period. As in the case of the Pennsylvania, the New York Central also experienced a plateau during the period studied. In 1963, the New York Central originated tonnage comparable to that originated during the base period. The experience of the New Haven was one of relative stability until the recession years of the late 1950s and, with one exception, has shown a marked decline so that in 1963 tonnage originated was almost 20 percent below that originated during the base period. Since 1968 both the Eastern District and the subject roads have experienced declines in tonnage originated.

Exhibits 31 and 32 cover the tonnage terminated in "Products of Agriculture." The index, as contained in Exhibit 32 for the United States as a whole, shows a decline in tonnage terminated in the Eastern District and for the subject roads.

A comparison of the absolute and relative changes in revenues received by the railroads for the transportation of "Products of Agriculture" is found in Exhibits 33 and 34. The index of revenues received, as developed from Exhibit 34, shows little or no change for total United States railroads over the period covered. In 1963, the railroads as a whole received almost 4 percent less than during the base period. The Eastern District experienced a similar decline in revenues received for the movement of "Products of Agriculture." The subject roads experienced somewhat comparable declines, with the New Haven's record being the worst. Its revenues in 1963 were approximately 13 percent less than during the base period. The relative change in both tonnage carried and revenues received as among the carrier groups would tend to indicate little or no intra-modal competition. This trend has continued since 1965.

The data, as a whole, seem to indicate that the subject roads and the industry are not participating in the growth of the markets for these commodities. Where growth has occurred, it has been very slight.

Coal Shipments

Since coal tonnage has historically been so important to the Pennsylvania and New York Central Railroads and continues to be so for the Penn Central, it is pertinent to examine the potential market for coal in future years and determine the extent to which the industry and the subject roads will participate in that market. Trends in tonnage and revenue are found in Exhibits 35 through 40. The examination of the future market for coal is covered elsewhere.

Exhibit 41 shows the method of transporting bituminous coal and lignite from mines during the period 1950–1970. These data were used to develop an index of relative change which is contained in Exhibit 42. The index indicates that in the past ten years the railroad industry has shown a steady increase in tonnage handled. However, the change has been less than the relative change in total production. In 1969, total production increased about 38 percent over the base period while rail movement increased only 24 percent. Significant increases occurred in the movement by water, truck, and utilization at mine site.

These exhibits show that while the railroad relative share has been increasing, it has not kept pace with the increase in total production. This is also illustrated by the diminution of the rail share of total production. In 1950, the railroads transported 81 percent of total production. By 1960, its share was 73 percent and decreased to 68 percent in 1970.

In 1970, of the 94,624,142 tons of coal which were transported by the Penn Central, 45.9 million tons or 48.6 percent, were delivered to electric utilities, the major portion of which was in the New England and East Central areas.[4] Based on the projections of the National Power Survey, the Penn Central, like other railroads, will find an intensified competitive situation.

Evidence of this competition is the extensive use of unit train movements. The unit train is considered as a system whereby more or less conventional cars are moved in supervised service with the capability and intention that part or all of the equipment be interchangeable with other general purpose equipment with or without control of the empty cars once a mission is completed. The unit trains have sometimes been termed "run-through" trains since they operate as an integral unit and bypass terminals. (In some instances the equipment is supplied by shipper or consignee.)

The Penn Central and its predecessor lines participated in numerous unit train tariffs for the movement of coal. In late 1970, according to a private study, the railroad was listed as a party in 66 tariffs covering unit train movements of coal. It could provide direct routing over its own lines in 36 of the tariffs. Further, in conjunction with other carriers, the Penn Central could provide a portion of the service covered by 32 tariffs. Since some tariffs list several routes, there are duplications which overstate the number of instances in which the Penn Central could participate. In the majority of instances, the equipment involved is railroad-owned equipment. The tariffs specify railroad supplied equipment in 55 cases and shipper or consignee equipment in 13 cases. This degree of involvement on the part of the Penn Central raises certain questions. Has the shift to unit trains generated enough extra tonnage to offset the loss of some or all of the margin over cost which the traffic contributes? Is the market for coal going to continue to expand at a rate which would justify the extensive investment in cars for that service?

There is no evidence that the increasing use of unit trains has increased the rail share of the coal market. The aforementioned exhibits show increasing rail tonnage but at a lesser rate than the expansion of the total market.

Projection of Coal Usage in Generating Electricity

The 1970 National Power Survey,[5] issued by the Federal Power Commission, has provided, through its regional advisory committees, some insights into the demand for electric power in the various U.S. regions in 1970, 1980, and 1990. An important part of the analysis involves the type of electrical generation, whether nuclear, fossil fuels, or hydro. The comprehensive study deals with many facets of the demand for electrical power but the amount of transportation needed in connection with an expanding power demand is of considerable importance in analyzing the future for railroads serving the Northeast and East Central regions, inasmuch as coal is an important commodity both on a tonnage and revenue basis for Eastern railroads. The Northeast region consists of essentially the 11 Northeastern states of Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York,

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[4] Hearings before Senate Committee on Commerce, *Review of the Penn Central's Condition—1971*, 92d Cong., 1st Sess. Serial No. 92–33, at p. 33 (1971).
[5] Federal Power Commission, *The 1970 National Power Survey*, Parts I, II, and III.

Pennsylvania, Rhode Island, Vermont, and the District of Columbia (see Exhibit 43). The East Central region extends from the southern and eastern shores of Lake Michigan and the Illinois-Indiana state line on the west to western Pennsylvania and western Maryland on the east, and from the lower peninsula of Michigan and Canada on the north to southern Kentucky and the borders of Tennessee and North Carolina. Exhibit 43 shows the boundaries of these districts.

The 1964 National Power Survey indicated that by 1980, 10 percent of the nation's KWH generation would be nuclear. However, the 1970 survey indicated that in the Northeast region, the nuclear generation had reached 10 percent in 1969, and that this power source would account for 60 percent of total generation in the Northeast by 1980 and 82 percent by 1990. In 1966, 57.9 million tons of coal were used for electric generation in the Northeast area. By 1980, the amount is estimated to be 56.8 million and by 1990, 40.6 million tons.[6]

In an expanding power market which necessitates substantially increased KWH generation, coal tonnage is expected to decline dramatically from 1980 on in the Northeast region, as shown in Exhibit 44.

In the Northeast, the concern regarding air pollution and the distance from coal sources have combined to cause a decrease in the importance of coal for boiler fuel. In spite of the use of unit trains or high speed shuttle trains which have improved transportation efficiency so as to reduce freight rates as much as 30 to 50 percent, the trend is away from coal usage.

The competitive aspects of other fossil fuels, such as oil and gas, are continuing to be intense but they too are expected to decline in relative and absolute terms as nuclear generation develops. Technological improvements, which have reduced the cost of extra high voltage transmission, have made the transportation of "coal by wire" more competitive. Thus a coal generating plant at the mine head which can be used for the transmission of electrical energy 600 to 700 miles away obviously has a deleterious effect on the transportation of coal. This reduces air pollution problems, particularly in metropolitan areas, as well as the cost of transporting and handling coal.

In 1966, the utilities industry considered that unit train rates from 4 to 6 mills per ton-mile were necessary to compete with other fossil fuels and the atom.[7] Even though reductions were effectuated through the institution of unit trains, it is reported that coal shipments in 1966 from Pennsylvania and West Virginia mines to Eastern destinations had a weighted average rate of 7.85 mills per ton-mile for an average haul of 414 miles; and unit trainload rates to New England destinations averaged 7.07 mills per ton-mile for an average distance of 605 miles.[8]

The increased use of nuclear generation and its expected acceleration in the Northeast area is shown in Exhibit 44. As this Exhibit indicates, approximately 10 percent of the Northeast region is currently served by nuclear generation. By 1980, this is expected to be 60 percent of the total and by 1990 to be approximately 82 percent. In the expanding power market in these two decades, the relative position of coal as fuel for Northeast electric generation plants is expected to decline significantly.

The East Central region of the National Power Survey embraces an area in which is located a major portion of the Appalachian coal resources. Historically, coal has provided most of the energy for utility purposes and in 1970, according to the survey, would supply about 97 percent of all electric energy requirements in the region.[9] In 1966, 82.3 million tons of coal were used in this area. The study projects an increase to 135.5 million tons in 1980 and 166.3 million in 1990.[10] This projected increase would indicate that the transportation potential for coal in this region is substantially better than that for the Northeast region. Competitive fossil fuels of oil and gas are of negligible significance but there is competition in the transportation of coal between

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[6] Id., II-1-20.
[7] Id., II-4-11.
[8] Id., II-4-12.
[9] Id., II-2-1x.
[10] Id., II-2-24.

water and rail, and the possibilities of mine mouth generation with "coal by wire" is another competitive factor. Another aspect of the coal traffic potential in the East Central region is that the average length of haul because of the proximity to the mines is less than in the Northeast region.

It is expected that an increase in total KWH generation will occur but increased use is expected to be made of nuclear generation so that by 1980 about 32 percent of electric generation will be nuclear and by 1990 about half of the power generation will be nuclear. Coal as a source of electrical energy in this region then is expected to decline from 97 percent in 1970 to about 50 percent in 1990, as shown in Exhibit 45. The projection for the East Central region indicates that the market for power will expand during the next two decades and coal as a source of energy will show an absolute increase in usage but its relative share of the total energy market will decline significantly. The elements of competition from intermodal carriers and from extra high voltage transmission will have some impact on this segment of traffic.

So in spite of reductions in freight rates averaging from 30 to 50 percent on some deliveries which are made possible by volume train movements, the advantages of competitive fuel, particularly nuclear energy, appears to be so substantial that the railroads cannot anticipate, even in the most favorable area of coal production (East Central), an expansion of electric generation.

Less-Than-Carload Service

The development of competitive and alternative modes of transportation in the 1920's resulted in significant inroads in the railroad share of traffic in less-than-carload freight. In 1920, the Class I railroads originated 52 million tons of less-than-carload tonnage, but this had dropped by 1939 to 36 million tons. This tonnage in 1947 amounted to 22.5 million tons which generated $522.4 million in revenue. As shown in Exhibit 46, it had declined by 1955 to 14,045,000 tons; by 1960 to 6,447,000 tons; and, in 1969, it was down to 1,279,000 tons. Revenue generated by this traffic had dropped to $35,589,000. In contrast, the revenues of motor carriers from this traffic had increased four-fold. The small shipments market has been expanding but the railroad share, both revenues and tonnage, has declined drastically.

The original rail less-carload lot service was on a station-to-station basis, and the cost of pickup and delivery at origin and destination was generally an additional expense. With the development of motor carriers with store-door to store-door service, the railroads in the 1930's instituted free pickup and delivery for less than carload traffic to meet motor carrier competition. Because of gasoline and rubber rationing during World War II, the rail LCL volume increased during the period from 1940 to 1946 by 66 percent. Within two years after the end of the war, motor carriers regained the momentum. The railroads, through pricing and service deficiencies, abetted the down trend of this traffic. Between 1946 and 1958, they received 14 general rate increases on a percentage basis. This meant that the highest rates applied on LCL traffic, and so this traffic segment of the railroads was very adversely affected. Motor carriers were granted rate increases, but typically they lagged behind rail increases, and their service was superior so traffic shifted increasingly to motor carriers.

Rail service on LCL traffic was also greatly influenced by the elimination of free pickup and delivery and/or the imposition of additional charges for collection and delivery of such freight within the Eastern Territory in the late 1940's and early 1950's. This was followed in 1957 by the Chicago Northwestern discontinuing pickup and delivery service completely and by a similar action by the Chicago Great Western in 1958. Other railroads adopted this practice and, in 1962, the Pennsylvania Railroad discontinued almost all its less-carload service. These actions affected other railroads, especially connecting lines, for it was no longer possible for the shipper to move freight in less-carload lots between many points on connecting lines. Essentially, a nationwide rail less-carload lot system no longer existed.

Another aspect of the small shipments involves freight forwarders. At one time, several of the largest forwarders were controlled by railroads but, by 1970, no railroads owned or controlled any Class A (annual gross of

$100,000) freight forwarder. On the other hand, 170 Class A freight forwarders are controlled by regulated motor carriers. In the small shipments field, freight forwarders who historically had utilized railroads increasingly used motor carrier service with the result that their transportation purchase of $188 million from the railroads in 1960 had declined to $174 million in 1970. During the same years, the purchase of motor transportation by freight forwarders had increased from $58 million to $89 million.

Shippers associations are handling some small shipments tonnage. Another small shipment category can be found in what is termed the miscellaneous mixed freight-all freight in which certain mixes of freight can be shipped in a single unit. A portion of this would fall in the small shipment category although the amount of this is not known—only the total tonnage of the contents is known.

The trailer-on-flatcar provides another area in which there are some small shipments but it is not possible to identify precisely the amount of less-carload lot traffic handled in such service. Some of it is obviously in substitution of less-carload or less-truckload.

The volume of these three categories—shippers associations, miscellaneous mixed freight-all freight, and trailer-on-flatcar—is not felt to be of sufficient magnitude for a detailed breakdown although they are competitive means of moving small shipments.

The volume of small shipments (defined for statistical purposes by the Interstate Commerce Commission as less than 10,000 pounds) tonnage has been growing, in part because of the efforts of businessmen to control inventories more closely and in part because of improved service of some of the modes. While there are numerous problems associated with this small shipment traffic, including its pricing, it should be pointed out that this traffic is now the primary source of revenue for the regulated motor common carriers.

Analysis of Census Data

One of the methods by which to ascertain rail participation in the total freight transportation market is to examine the data contained in the 1963 and 1967 Censuses of Transportation. The material covered in these Censuses provides some insights which have not heretofore been available, and permits a limited check of two points in time of total market, as well as the proportionate shares of this market held by the different modes of transportation.

The Census data cover movements of manufactured and processed commodities that originate at manufacturing establishments (as defined in the Census of Manufacturing based on the standard industrial classification). This obviously excludes the flow of agricultural commodities as well as unmanufactured minerals. Manufactured products which are reshipped from a warehouse or distribution center are also not included.

The data in the Census consist of the traffic which historically has been the most profitable and should be of special revenue value to the railroads. Exhibit 47 compares the relative changes during the period 1963–1967 of both total tonnage generated by the shipper groups used by Census and the rail share of the same. During the aforementioned period, the total tonnage increased with the exception of but three shipper groups. At the same time, the rail share of tonnage originated decreased in 16 of the 24 shipper groups. This meant that with the exception of shipper group 12 (furniture, fixtures, and miscellaneous manufactured products) which showed a very slight decline, the rail share of tonnage generated was decreasing while the total market was increasing for the 16 categories. Perhaps more importantly, in the eight shipper groups where the railroad share increased, that increase, with but three exceptions, failed to keep pace with the growth in the market.

As noted before, the data are limited in the fact that but two points in time are being compared. However, it would certainly appear that the railroads have failed to generate growth in this important traffic and in a period of general economic growth and expansion in our country.

Exhibit 48 provides a comparison of relative changes in total ton-miles generated by the shipper groups and the rail share of that ton mileage. With

few exceptions, the data indicate a similar pattern of decline in rail participation. Only five of the 24 shipper group categories showed a decrease in total market ton mileage between 1963 and 1967. The percentage decreases from highest to lowest are group 8 (13.5 percent), group 24 (10.1 percent), group 22 (5.8 percent), group 13 (2.1 percent), and group 4 (1.8 percent). The increases in the other 19 categories ranged from 86.5 percent to 1.0 percent. In 13 categories, the increase exceeded 15 percent or more. The rail share of the total ton-mile market shows a decrease in 16 categories despite the expanding ton-mile market. The range of the decrease is from a high of 11.1 percent to 0.7 percent. In 13 of the 16 categories, the decline exceeds 3 percent.

The increase in the rail share of the ton-mile market between 1963 and 1967 applies in eight of the 24 shipper groups. However, except in two of these categories, their increase is less than the increase in the total ton-mile market. During a period of expanding tons and ton-mile markets for the 24 shipper groups, the overall railroad share either failed to match the growth in the market or declined significantly. By significantly, we mean the railroad share of the market declined at a time when the total market was expanding. This erosion of their market share assumes special importance because the economy was expansionary and because of the nature of the traffic involved (manufacturing and/or processed) whose revenue contribution is relatively greater than other categories of traffic.

Intermodal Competition

As our population has become urbanized, it has moved toward a dispersed urban pattern. Many of the new industrial parks and shopping centers are completely dependent upon truck transportation. Even in intercity transportation, there are so many competitors for both the general commodity traffic and the specialized commodities, such as those in bulk, that the railroads generally are not participating to a sufficient degree in general traffic growth.

Intermodal competition provided by regulated for-hire motor carriers possesses certain advantages for shippers. It offers a complete service that is store-door to store-door. This mode of transportation also allows a considerable degree of latitude in ordering shipments which is very important in physical distribution management. The movement of small shipments expeditiously enables shippers to reduce their inventory carrying costs because they do not have to have as much inventory on hand. In addition, shippers have had a greater latitude in packaging their shipments as these requirements generally have not been as restrictive as those of the railroads. The development of specialized equipment in motor transportation has made it possible, through the use of specialized carriers such as tank trucks, to tailor the movement of bulk commodities—flour, sugar, chemicals, and other dry or liquid commodities—to meet the needs of shippers. Other specialized motor carriers transport commodities of unusual value, household goods, and heavy equipment.

The average speed in motor transportation is double that of rail which is a factor of importance in delivery of shipments. Currently, 76 percent of the 42,500 miles of the interstate highway system is open which allows truck shipments to be moved even more expeditiously. The interstate system, upon its completion, will link all major metropolitan areas in the United States and thus provides a basic network of high speed, limited-access highways for motor transport.

The size of the motor carrier unit, too, provides a substantial degree of flexibility. The use of twin trailer combinations, which consist of a tractor and two semi-trailers, each of which is 24 to 28 feet in length, is permitted on the highways of 33 states. As more of our freight gets lighter in weight (with the use of plastics and aluminum) and bulkier in size, the increase in cubic capacity and heavier loading which twin trailers permits makes motor carriers more competitive.

Motor carriers that transport agricultural commodities are exempt from economic regulation, and these carriers have been a keen competitive segment in the transportation of livestock and agricultural commodities.

Perhaps the most incisive competitive factor, however, is that of private trucks which a company can operate in transporting its own products. Since

equipment of general or special type can be leased, a company does not even have to invest in transport equipment in providing its own service.

The speed and larger capacity of many of our new jet planes have enabled airlines to develop cargo services for small and medium-size shipments of a wide range of manufactured or processed goods. Although the volume is small as compared to surface transport, the planes are becoming more of a competitive factor on certain traffic segments.

In large bulk commodity flows, a substantial measure of competition is generated by the inland water carriers and pipelines for transportation of such commodities as coal, ore, grain, and petroleum.

An additional aspect of competition is the increased use of the physical distribution concept by business firms. This management of transportation, storage, protective packaging, inventory, and material handling to and from the production line has widespread and intensive application in industry. The embraced areas are managed as a system, and there are numerous opportunities for managerial trade-offs to meet a company's objectives. Thus, a firm may seek improved customer service which can result in changed transportation requirements which, in turn, can affect warehousing, inventory, and packaging requirements.

The emphasis upon physical distribution management is resulting in more effective control of each of its components which means that for-hire carriers will have to be more responsive to reliability and performance requirements with attractive pricing of their service in order to participate in future traffic.

In order to gain insight into the degree to which the subject railroads have competed successfully in the transportation market, a compilation was made of the freight revenues generated by various modal groups. These groups included: Class I railroads, Class I motor common carriers, freight forwarders; Eastern District railroads, Eastern District motor common carriers; and the three railroads—Pennsylvania, New York Central, and New Haven. The data are found in Exhibit 49, and an index using 1957–1959 as base years was calculated and is found in Exhibit 50.

As illustrated in Exhibit 50, the growth experienced by Class I motor common carriers was substantially greater than either the growth of the Class I railroads or the freight forwarders. The Class I railroads, in 1969, generated freight revenues approximately 22 percent in excess of those generated during the base period; and the freight forwarders generated freight revenues about 39 percent greater than in 1957–1959. On the other hand, the revenues of the Class I motor common carriers in 1969 were 179 percent above their revenues during the base period. To some extent, this substantial increase has been affected by the smaller revenue base of Class I motor common carriers. Even discounting this factor, their rate of growth has been considerably greater than for the other two modes.

The index illustrates the failure of the Eastern District railroads to grow at a rate comparable to that of the Class I railroads as a whole. In 1969, the Eastern District railroads had revenues which were about 9 percent above the level which they had during the base period. The Eastern District motor carriers, on the other hand, have increased their freight revenues comparably with the Class I motor common carriers as a whole. It is difficult to state that the growth of the Eastern District motor carriers has been at the expense of the Eastern District Class I railroads since the designation "Eastern District motor carrier" merely includes those carriers domiciled in a certain part of the nation. There is little doubt, however, that many of the motor carriers geographically located in the Eastern District of the railroads are indeed quite competitive with the railroads as regards their service areas.

With regard to the individual railroads depicted, i.e., Pennsylvania, New York Central, and New Haven, their rate of growth has, with the exception of the New Haven, compared favorably with the growth in the Eastern District, primarily because the Pennsylvania and the New York Central are the two dominant lines in that district. As in the case of the Eastern District, the rate of growth as reflected by revenues of the Pennsylvania Railroad and the New York Central Railroad has been less than for all Class I railroads.

The performance of the New Haven during the period 1954 until 1968 when it was merged into the present Penn Central shows a steady decline in freight revenues received. Exhibit 50 shows that, in 1968, the road received freight revenues that were about 23 percent below the revenue level experienced during the base period.

Exhibit 51 provides data comparing tonnage generated by the various modes covered in Exhibit 49 and for the same period of time. As in the case of freight revenues shown in Exhibit 50, the index of tonnage generated, found in Exhibit 52, shows that both Eastern District carriers as a whole and the two principal roads in the Eastern District, the Pennsylvania and the New York Central, have not participated to a comparable degree in the growth of tonnage generated by Class I railroads as a group.

Perhaps the most salient point is found in a comparison of tonnage and revenues included in the abovementioned exhibits. The rate of growth in tonnage for the railroads as a group is fairly comparable to their rate of growth in revenues whereas the motor carriers, as a whole, and those domiciled in the Eastern District, have actually experienced a decline in tonnage while achieving the rather significant increase in freight revenues for the same period. It would appear that the motor carrier industry has been very successful in capturing very profitable traffic.

Selected Class I Motor Common Carriers

In an effort to determine the extent of motor carrier competition for the Eastern District rail carriers and the principal roads being studied, a group of Class I motor common carriers was selected for examination. These carriers have extensive operating rights within the Eastern District and thus provide the potential competition not only within the Eastern District but also provide single-line service to many areas of the country. Exhibit 53 illustrates the growth of these selected carriers during the last 16 years, with yearly data covering the last 11 years. Exhibits 54 through 58 show the operating rights of certain of these carriers; and Exhibit 59 provides a historical overview of the growth through merger and acquisition of certain of the carriers. As shown in Exhibit 53, since 1955 the revenues of these 12 motor carriers have increased about 300 percent. This compares with the growth of the Eastern District railroads during the period 1955–1969 of 4 percent and 4.5 percent for a combined Pennsylvania-New York Central Railroad. The period 1960–1970 shows that the carriers, with the exception of individual years for certain carriers, exhibited a steady growth in revenues. During the same period, the principal railroads in the Eastern District and the Eastern District as a whole experienced a much lower rate of growth.

The significance of these extensions of operating rights which these carriers have experienced is primarily two-fold: not only can they provide direct competition within and between districts but they also can provide single-line service in both instances. Illustrative of these general commodity carriers are three with transcontinental operating authority—Consolidated Freightways (Exhibit 54), P–I–E (Exhibit 55), and Yellow Freight System (Exhibit 56)—and two with regional authority—Associated Transport (Exhibit 57), and Roadway Express, Inc. (Exhibit 58).

An indicator of the amount of competition provided by regulated intercity motor carriers of general commodities can be found through analyzing the number of carriers in 1964 holding operating authority to serve the designated city both as to origin and termination of shipments (many more carriers have operating authority which is limited either to provide origin service or to provide termination service to a particular city than to provide both origin and termination service). This tabulation is by size of carrier at a number of metropolitan areas in the Eastern District and New England.[11]

[11] Tabulation by Assistant Professor Jay Smith, Southern Illinois State University, Carbondale, Illinois.

	Class		
	I	II	III
New York	149	64	45
Chicago	180	52	20
Philadelphia	111	39	56
Cleveland	81	12	4
Pittsburgh	60	29	15
Baltimore	81	21	15
Boston	88	58	99
Indianapolis	76	11	3
Akron	74	9	2
Detroit	70	10	9

As recently as 1960, there were two regular route general commodity carriers operating from coast-to-coast but through acquisition, there are now nine. Several motor carriers have authorized regular route mileage greater than that of any railroad. The development of these transcontinental carriers provides the shipper with single-line service that is a strong competitive advantage for motor carriers. (Yellow Freight System shipments in 1970, for example, moved an average distance of 1,175 miles according to Yellow Freight's 1970 annual report.)

Qualitative Aspects of Rail Freight Service

Typical shipper dissatisfaction with carrier service is reflected in complaints filed with the carrier; and over a period of time, if there are not improvements to correct service deficiencies, the shipper may turn to competitive for-hire modes of transportation or supply his own transportation service in the form of truck or barge service. In a recent Interstate Commerce Commission proceeding, Ex Parte 265 *Increased Freight Rates, 1970*, and Ex Parte 267 *Increased Freight Rates, 1971*, decided March 4, 1971, the Commission invited all parties to Ex Parte 265 to submit examples of deficiencies or inadequacies in railroad service as well as recommendations they wished to make on how such conditions might be corrected. Details regarding this are found at 339 ICC 136–156. Twenty pages of detailed rail service deficiencies, some of it in summary form, were submitted. The service deficiencies mentioned by coal shippers include car shortages, uncooperative and inefficient labor, excessive transit times, bad order cars, poor switching service, inadequate road bed maintenance, and lack of motive power.

Toledo Edison indicated "* * * extremely poor service of the Penn Central at its Acme and Water Street generating stations." [12] With a standing order to the Penn Central for daily delivery of 50 carloads of coal at its Acme station, this company's weekly summary from April 14, 1970 to June 6, 1970, recorded 696 cars not received during the 8-week period.[13]

Consolidated Edison Company of New York stated that it failed to receive tens of thousands of tons of coal during 1969 as a result of the inability of the railroads to deliver an adequate number of coal cars to the coal mines.[14]

The General Mills Corporation in Ex Parte 265 (1970) and Ex Parte 267 (1971) presented evidence that on-time reliability of the railroads, which the railroads agreed should be 90 to 95 percent, was 65–72 percent in 1966 and had not improved since. General Mills said that railroads exercise little control over the quality of their service in the movement of either a loaded freight car from a loading facility to an unloading facility or an empty freight car in "car distribution." This company stated that there are few performance standards" and little "measure of performance." [15]

These examples are illustrative of the many pages of service inadequacies. Exhibit 59A contains a summary of such service deficiencies.

[12] 339 ICC 138.
[13] Id.
[14] Id.
[15] Presentation by William K. Smith, Vice President, General Mills, February 16, 1971, in Ex Parte 270, p. 8.

NON-RAIL SURFACE TRANSPORTATION SUBSIDIARIES

The examination of the non-rail subsidiaries is confined to the major surface transportation subsidiaries. Their operation is important since their performance could adversely affect the financial and managerial posture of the railroad. While there has been little publicity concerning their operations since the declaration of bankruptcy, other of the railroad's subsidiaries have created both financial and managerial drains on the railroad. The Penn Central either owns completely or controls two pipeline companies and five motor carriers. These subsidiaries are Buckeye Pipe Lines, Everglades Pipe Lines, Merchants Trucking Co., New England Transportation Company, New York Central Transport, Pennsylvania Truck Lines, Inc., and Penntruck Co.[16] The individual operations are different in nature. Merchants Trucking and New England Transportation Co. are principally involved in the movement of general freight between cities.

The other three to be examined, New York Central Transport, Pennsylvania Truck Lines, and Penntruck, derived substantial parts of their revenues from local operations. In each instance, the carrier's operations are compared with the aggregate group involved in comparable operations.

Exhibit 60 provides a comparison of operating ratios achieved by Merchants Trucking and New England Transportation Co. and those achieved by all Class I intercity common carriers. The comparison covers the period 1965–1970. It shows two different operations. During the period, Merchants consistently achieved a better operating ratio than that achieved by all Class I common carriers. On the other hand, New England never managed to achieve a ratio which equaled that of the Class I common carriers. This experience of the two carriers carried over in the comparison of relative revenue growth shown in Exhibit 61. This Exhibit compares the revenue growth achieved by the two carriers with the revenues generated by all Class I intercity common carriers. The index is based on the 1967 experience. While the revenue growth experienced by Merchants was more than all Class I common carriers, New England Transportation Co. grew but not at a rate equal to the aggregate.

Exhibits 62 and 63 provide comparisons for the three rail subsidiaries providing local service. The operating ratios of the three carriers are compared with the operating ratio achieved by all local carriers of general freight in Exhibit 62. With the exception of Pennsylvania Truck Lines, the Penn Central subsidiaries achieved lower operating ratios than all general freight local carriers. In fact, the ratios achieved by New York Central Transport would indicate a very profitable posture.

Exhibit 63 gives the revenue growth of the three subsidiaries and compares it to the growth of all general freight carriers providing local service. All the carriers experienced a growth in revenue during the 1965–1970 period while the revenues generated by all local carriers was declining. As expected, the rate of growth varied greatly as between the carriers, with New York Central Transport registering the highest relative growth. The lowest growth of the three was registered by Pennsylvania Truck Lines, Inc., which was manifested in the high operating ratios shown in Exhibit 62.

As a whole, it would appear that the motor carrier subsidiaries owned by the railroad have not provided either a financial or managerial drain on the carrier. Moreover, the merger of four of these subsidiaries into a single carrier, as aforementioned, has potential benefits for the future. The carrier must still contend with the continuing unprofitable posture of the New England Transportation Co. As early as 1954, this carrier's poor performance was a burden on the New Haven prior to its inclusion in the Penn Central and has now become a problem for the carrier.

The performance of the major pipeline owned by the Penn Central is examined in Exhibits 64 through 66. Exhibit 64 provides a comparison of revenues and production generated by Buckeye and United States pipelines as

[16] As of January 1, 1972, New York Central Transport, Pennsylvania Truck Lines, Inc., Penntruck Co., and Merchants Trucking Co. were merged and retained the name Pennsylvania Truck Lines, Inc.

a whole. These data are utilized to develop indices of both revenues and production which are included in Exhibits 65 and 66, respectively. Exhibit 65 shows that during the period 1955–1969, Buckeye Pipeline grew at a faster rate than United States pipelines, as measured by revenues. Buckeye registered revenues approximately 71 percent greater than the base period (1957–1959) while all pipelines generated revenues approximately 49 percent above the base period.

A comparison of production, as represented by total barrels delivered out of the system, shows an opposite trend. Over the period 1955–1969, as illustrated in Exhibit 66, all pipelines exhibited a stronger trend in barrels delivered than Buckeye. In 1969, all pipelines generated 73 percent more barrels than during the base period while Buckeye produced 55 percent more.

Taken together, the trends indicate that Buckeye has a more profitable traffic consist than all United States pipelines since it generated more revenues from the product transported.

Thus, with the exception of the apparent unprofitable posture of the New England Transportation Co., the major nonrail transportation subsidiaries would appear to provide no strain upon the parent company.

Passenger Traffic

In the early and middle 1950's, the railroads attempted to lure intercity passengers to train service with large expenditures for new equipment and the institution of service and pricing inducements. Generally they were not successful in their efforts to hold and attract customers, and passenger service continued to be an increasingly heavy drain on rail revenues.

As measured by intercity passenger-miles of travel in 1970, motor vehicles account for 88.73 percent; air transportation 10.01 percent; and railroads 0.92 percent. Twenty years ago, the division was motor 91.3 percent, air 1.7 percent, and railroads 6.8 percent. There has been a decline of railroad intercity passenger-miles in spite of an expanding travel market. Air transport has become the dominant for-hire passenger carrier on a passenger-mile basis.

Exhibit 67 shows a comparison of passenger revenues received by all Class I railroads, Eastern District railroads, and the subject railroads. The period covered is 1954–1969.

Exhibit 68 is an index developed from the data found in Exhibit 67 and is based on the 1957–1959 experience. All of the indices show a significant rate of decline from 1954 on. The Class I railroads received revenues for the movement of passengers in 1969 which were about 35 percent less than those for the base period. At the same time, the railroads located in the Eastern District experienced an approximate decline of 30 percent in revenues received. Prior to the merger, the Pennsylvania Railroad had experienced a decline similar to that of the Eastern District roads as a whole while the New York Central's revenues declined to a greater extent (48 percent). The New Haven at the time of its inclusion showed the least decline with approximately 27 percent. Even though it would appear that the New Haven has suffered a lesser decline than the other two roads, much of its revenue is generated from commuter operations which cannot easily be abandoned.

Most railroads, including the Penn Central, turned their money-losing intercity passenger service over to a new quasi-public agency, Amtrak, beginning in May 1971. This has resulted in some improvement of the passenger deficit. The Trustees of the Penn Central have stated, however, (Report of Trustees to U.S. District Court for Eastern District of Pennsylvania, February 15, 1972) that inadequacies of the present contract with Amtrak, as well as the heavy losses it sustains in commuter service, must be remedied. Amtrak does not share the Penn Central's view, but some readjustments have been made. When one considers that more than two-thirds of the train miles operated in the Boston-Washington corridor are in passenger service, it should be apparent that the Amtrak contract should be equitable for all involved.

Efforts of the past several years to upgrade rail passenger service in the corridor between Washington, D.C. and New York by use of new equipment with high speeds and other passenger service improvements, are making money.

The service between New York and Washington is the most consistent money maker in the Amtrak system.

Innovative Efforts to Stimulate Freight Traffic

Although earlier efforts had been made, it was during the early 1950's that trailer-on-flatcar service (TOFC) was instituted and subsequently container-on-flatcar (COFC). As the service was offered, several variations developed which became identified by number. These are:

Plan I. Railroad movement of trailers or containers of motor common carriers, with the shipment moving on one bill of lading and billing being done by the trucker. Traffic moves under rates in regular motor carrier tariffs.

Plan II. Railroad performs its own door-to-door service, moving its own trailers or containers on flatcars under tariffs usually similar to those of truckers.

Plan II½. A combination of Plans II and III whereby the railroad furnishes the trailer or container but the shipper performs the service to and from rail terminals.

Plan III. Ramp-to-ramp rates based on a flat charge, regardless of the contents of trailers or containers, owned or leased by freight forwarders or shippers. No pickup or delivery is performed by the railroad.

Plan IV. Ramp-to-ramp rail movement of trailers or containers owned or leased by shippers or freight forwarders.

Plan V. Traffic moves generally under joint railroad-truck or other combination of coordinated service rates. Either mode may solicit traffic for through movement, and either mode will bill for the traffic.

After considerable growth over a number of years, TOFC traffic leveled off and, in 1970, decreased. The economic downturn was probably responsible in part for this but the rate of growth had not been as rapid during the past four years as had been true in earlier years. The market for this type of traffic has been rather thoroughly sold and special additional efforts will have to be made to develop greater TOFC traffic. Exhibit 69 shows the growth of this traffic by plan during the period 1964–1970. As TOFC traffic has increased, the percentage under Plan I of this traffic, which involves transportation for motor common carriers, has declined from 25 percent in 1964 to 10 percent in 1970. Under Plan II, which is the basic railroad service performed door-to-door and designed to be competitive with motor carriers, the relative share has declined from 39 percent in 1964 to 35 percent in 1970 despite an expansion of the total TOFC and COFC market. The great growth that has occurred during this period has been in Plan II½ in which the railroad furnishes the trailer or container but the shipper performs the service to and from rail terminals.

TOFC carloadings as a percentage of all carloadings have grown from 2.6 percent in 1963 to 4.8 percent in 1969.

Evidence of the Penn Central's awareness of the importance of this traffic is found in the Report of the Trustees to the U.S. District Court for Eastern District of Pennsylvania, dated February 15, 1972, wherein on page 4 the Trustees stated:

> Penn Central is becoming a more effective competitor. Divergence of views regarding piggyback service on the part of the former New York Central, Pennsylvania, and New Haven, and unfulfilled commitments after the merger—along with increases in piggyback rates almost twice as great as increases in truck rates—resulted in a post-merger drop in Penn Central piggyback business from 520,000 trailers in 1968 to 420,000 trailers in 1971. In the last half of 1971, when Penn Central's new services and reduced rates began to take effect, that trend was reversed.[17]

The development of unit trains during the past decade has enabled the railroads to become more competitive in the bulk commodity categories, both in service and price, than had earlier been the case. The unit trains are made up of a designated number of cars, typically 50 or more, each loaded with a mini-

[17] See Appendix D, Exhibit 54, p. 632 for text of Trustees' February 15, 1972, Report on Reorganization Planning.

mum tonnage per car, and the entire train carries but a single commodity, primarily bulk. The unit trains operate between two established points in a shuttle service. This enables the operation to be rather precisely scheduled by bypassing classification yards, and by eliminating the coupling and uncoupling of cars, the turn-around time can be minimized. In some instances, the bulk products can be loaded and unloaded automatically while the train is in motion. The most common unit train has been that hauling coal between mines and public utility plants.

In unit train service, the equipment which is used is typically dedicated to that particular service. In some instances, the rail cars have been purchased and are owned by the shipper, such as a utility company.

Unit trains have been placed in operation for a number of commodities including ore, grain, fertilizer, chemicals, and steel slabs.

In addition to those of coal and grain, the Penn Central has one which is designed to transport logs for processing into pulp for paper making. This particular operation is one in which the paper company provides 136 cars that are extra long and have high sides. This type of car triples the capacity of the gondolas previously used.

One of the most successful traffic recoveries by railroads has occurred with their development of specialized (rack) cars to haul new automobiles. This equipment, coupled with a rate adjustment and improved service, enabled railroads to secure 51.6 percent of this traffic as measured by gross revenues as compared with but 14.9 percent in 1959. The motor carrier share during this same period dropped from 83.6 percent to 48.2 percent.

Multiple car rates have also been established that apply a lower rate for a designated number of cars, such as five. These cars move as a single shipment at a lower rate than would apply on individual cars. Such pricing incentives have been applied on a number of different commodities.

THE PENN CENTRAL MERGER: A STUDY OF ITS PLANNING, APPROVAL, AND RESULT

CONTENTS

The Penn Central Merger: Planning, Approval, and Result

On February 1, 1968, The New York Central Railroad Company (NYC) was legally merged into The Pennsylvania Railroad Company (PRR) to form what is now known as Penn Central Transportation Company (Penn Central or PC), the largest railroad system in the United States at that time.[1] Fewer than 30 months later, on June 21, 1970, Penn Central filed a petition for reorganization under § 77 of the Bankruptcy Act in the Federal District Court at Philadelphia where reorganization proceedings are now pending.

This report reviews the Penn Central merger proceedings before the Interstate Commerce Commission and the courts, summarizes presently available information about the PRR/NYC plans for merger, and analyzes the part the merger played in the ultimate collapse of Penn Central.

A short summary of pertinent statutory provisions in the Interstate Commerce Act (ICA) may be helpful in understanding the complex world of railroad mergers.[2] Under ICA § 5(2)(a),[3] two or more railroads may consolidate or merge their properties or franchises into one corporation with the prior approval and authorization of the ICC. The Commission's approval is also required when one railroad, or two or more jointly, acquire control of another railroad through purchase of its stock or otherwise. Any party proposing a subject transaction must first present an application to the ICC. After appropriate procedures, if the Commission finds that the proposed transaction will be consistent with the public interest, "it shall enter an order approving and authorizing such transaction" upon such terms, conditions and modifications as it finds just and reasonable.

Under ICA § 5(2)(c),[4] in passing upon any proposed merger or other unification transaction, the Commission is directed to give weight to (1) the effect of the proposed transaction upon adequate transportation service to the public; (2) the effect upon the public interest of the inclusion of, or failure to include, other railroads in the territory involved in the proposed transaction; (3) the total fixed charges resulting from the proposed transaction; and (4) the interest of the carrier employees affected.

Under § 5(2)(d),[5] when the proposed transaction involves railroads, the ICC is authorized, as a prerequisite to its approval, to require the inclusion of another railroad in the territory involved upon petition by the railroad requesting inclusion. The terms of inclusion must be equitable, and the Commission must find that the inclusion is consistent with the public interest.

Section 5(2)(f) [6] provides that as a condition of approval of any unification involving a railroad, the Commission shall require protection of the interests of the railroad employees affected. The Commission must include conditions providing that for four years after the effective date of its order of approval, the transaction approved will not put employees of the railroad affected by the

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[1] Railroads are often designated in this chapter by their widely used common names or initials.
[2] Rail unifications are subject to §§ 5 (2) to (13), inclusive, of the Interstate Commerce Act (hereinafter cited as ICA), 49 U.S.C. §§ 5 (2)–(13).
[3] ICA § 5(2)(a), 49 U.S.C. § 5(2)(a).
[4] ICA § 5(2)(c), 49 U.S.C. § 5(2)(c).
[5] ICA § 5(2)(d), 49 U.S.C. § 5(2)(d).
[6] ICA § 5(2)(f), 49 U.S.C. § 5(2)(f).

74-924 O - 73 - 22

order in a worse position with respect to their employment. However, the employee shall not be protected for a period longer than the period of his employment by the railroad prior to the effective date of the approval order. The last sentence of the section is a "notwithstanding" proviso: notwithstanding any other provisions of the Act, an agreement pertaining to the protection of the affected railroad employees "may hereafter be entered into" by any railroad and the authorized representative of its employees.

Chronology of the Merger

For many years prior to 1950, rail transportation in the Eastern District was dominated on a territorial basis by PRR, NYC, the Baltimore and Ohio (B&O) and the Erie. Other rail carriers provided important service in parts of the district as, for example, the Chesapeake and Ohio Railway (C&O), the Norfolk and Western Railway (N&W) and the Virginian in the Southern Appalachian (Pocahontas) coal fields in southern West Virginia and Virginia. The New York, Chicago and St. Louis Railroad Company (Nickel Plate or NKP) and the Wabash operated lines reaching important parts of the region west of Pittsburgh and Buffalo. In addition to the longhaul trunklines, numerous linehaul railroads of lesser length served various parts of the East as, for example, the Reading and the Central Railroad of New Jersey along the eastern seaboard north of Hampton Roads and the Lehigh Valley connecting Lake Erie and New York City through the declining Pennsylvania anthracite coal fields. In the central area were the Pittsburgh and West Virginia (P&WV) and the Akron, Canton and Youngstown Railroad (AC&Y), among others. The New England lines with substantial coverage in the upper northeast sector were the New Haven (NH), the Boston and Maine Railroad (B&M) and the Boston and Albany arm of NYC.

Prior to 1950, the Eastern railroads, with several notable exceptions, had been generally profitable, except in the depression years of the 1930's. PRR, then one of the two or three strongest railroads in the nation, had an exceptional earnings record as did the Pocahontas lines. However, NYC and B&O encountered difficulties at times. The Erie had an unfavorable debt structure and low earnings and so had more serious problems. The New England lines, particularly the New Haven, were in perennial trouble. The passenger train deficit had been a burden since the 1930's, except for the war years; competition from trucks and other transport modes intensified in the years following the end of World War II; and signs of railroad decline in the East were appearing with increasing frequency.

In the decade beginning with 1950, the railroads generally suffered a decline in traffic and revenue. Technological improvements did not stem the adverse trend. A series of general increases in rates improved revenues, but the increases were offset by higher costs. In the East, overall earnings declined as did the net income of important lines. In the case of both PRR and NYC, for example, net railway operating income in 1957 through 1959 failed to meet fixed charges by substantial amounts. In this atmosphere of decline, the railroads searched for means of improving their position in a highly competitive transport economy.

From the early days of the railroads, merger and consolidation have been frequently used to expand operations and to achieve the economies of scale. As far back as 1907, the ICC formally reviewed the consolidation and combination of railroads,[7] and the subject has been repeatedly studied since 1920. An active phase in the long history of railroad regroupings opened in the latter part of the 1950–59 decade and is not yet concluded. This phase has been nationwide and has substantially revised the railroad system of the country.

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[7] Consolidations and Combinations of Carriers, 12 I.C.C. 277 (1907).

CHRONOLOGY OF EASTERN RAILROAD MERGERS

Penn Central	N. & W. System	C. & O.-B. & O.	Other
1959	1959	1959	1959
Jan. 8: N.Y.C. terminated first negotiations with P.R.R. begun in November 1957.	Apr. 6: N. & W.-Virginian merger application filed with ICC. Oct. 8: N. & W.-Virginian merger application approved, 307 ICC 401. Oec. 1: N. & W.-Virginian merger consummated.		July 6: E.L. merger application filed with ICC.
1960	1960	1960	1960
		June 14: C. & O.-B. & O. control application filed with ICC.	July 22: Seaboard Air Line-Atlantic Coast Line application filed with ICC. Sept. 13: E.L. merger application approved, 312 ICC 185. Oct. 17: E.L. corporate merger effected.
1961	1961	1961	1961
October: P.R.R.-N.Y.C. negotiations resumed.	Mar. 17: N. & W.-N.K.P.-Wabash applications filed with ICC. Apr. 14: Sandusky line trackage application filed by P.R.R. with ICC. Oct. 12: N. & W.-E.L. agreement re E.L. inclusion executed.	June 19–Oct. 9: Hearings on C. & O.-B. & O. application.	Feb. 17: Northern Lines merger application filed. May 16: E.L. forces and facilities consolidated. July 7: N.H. reorganization petition filed. Oct. 10: Northern Lines hearings began.
1962	1962	1962	1962
Jan. 12: P.R.R.-N.Y.C. merger agreement signed. Mar. 9: P.R.R.-N.Y.C. merger application filed with ICC. Apr. 4: P.R.R. control of Lehigh Valley approved, 317 ICC 139. Aug. 20: Hearings began.	Jan. 10: N. & W.-A.C. & Y. application filed. Aug. 21: N. & W.-P.W.V. application filed.	Jan. 29: N.Y.C. authorized to withdraw from C. & O.-B. & O. cases. Oec. 17: C. & O. control of B. & O. approved.	Apr. 5: President Kennedy's transportation message to Congress. June–July: Hearings before Senate Judiciary Subcommittee on bill to postpone rail mergers. July 10: Northern Lines hearings ended.
1963	1963	1963	1963
Oct. 1: Saunders became chairman of P.C.; Justice Oepartment stated opposition of Governent to P.C. merger at the hearings. Oct. 2: Hearings ended.		Jan. 25: Labor union appeal C. & O.-B. & O. approval filed in Michigan. Feb. 4: C. & O. control of B. & O. consummated after Federal district court on Feb. 1 did not restrain consummation temporarily. Dec. 9: Supreme Court affirmed C. & O. control of B. & O., 375 US 216.	Oec. 2: Merger of Seaboard Air Line and Atlantic Coast Line approved, 320 ICC 122.
1964	1964	1964	1964
May 20: P.R.R.-N.Y.C. labor attrition agreement signed. Sept. 16: Further hearing held on labor matter.	June 24: N. & W.-N.K.P.-Wabash etc. merger approved, 324 ICC 1. Oct. 16: New N. & W. system began operation.	June 24: C. & O.-B. & O. filed application to control Western Maryland.	Aug. 24: Examiner's report in Northern Lines case served.

CHRONOLOGY OF EASTERN RAILROAD MERGERS—Continued

Penn Central	N. & W. System	C. & O.-B. & O.	Other
1965	1965	1965	1965
Mar. 29: Examiners recommended approval of P.C. merger, 327 ICC 566.	Sept.: E.L., D. & H. and B. & M. inclusion petitions filed in N. & W. merger cases. Oct. 11: N. & W.-C. & O. merger application filed with ICC.		
1966	1966	1966	1966
Apr. 6: Penn Central merger first approved by ICC, 327 ICC 475. Sept. 16: Approval of P.C. merger affirmed by ICC on reconsideration, 328 ICC 304.			
1967	1967	1967	1967
Mar. 27: Supreme Court postponed P.C. approval pending decision on inclusion of L.E., D. & H. and B. & M., 386 U.S. 372. June 9: Traffic indemnity provision for E.L./B. & M./D. & H. protection modified by ICC, 330 ICC 328. Nov. 16: Inclusion of N.H. in Penn Central ordered by ICC, 331 ICC 643, 754.	June 9: Inclusion of E.L., D. & H. and B. & M. in N. & W. ordered by ICC, 330 ICC 780. Sept. 1: Terms for D. & H. inclusion in N. & W. modified, 331 ICC 22.	Feb. 21: C. & O.-B. & O. control of Western Maryland approved, 328 ICC 684.	July 1: Merger of S.A.L. and A.C.L. as Seaboard Coast Line Railroad consummated.
1968	1968	1968	1968
Jan. 15: Supreme Court approved Penn Central merger, 389 U.S. 486. Feb. 1: Penn Central merger consummated.	Jan. 15: Supreme Court approved E.L.-D. & H.-B. & M. inclusion in N. & W. Apr. 1: E.L. included in N. & W. system. July 1: D. & H. included in N. & W. system.	Mar. 29: Control by C. & O.-B. & O. of Western Maryland consummated.	Apr. 11: Approval of Northern Lines merger affirmed by ICC with modified conditions, 331 ICC 869.
1969	1969	1969	1969
Jan. 1: Penn Central took over operations of N.H.			
1970	1970	1970	1970
June 21: Penn Central reorganization petition filed in Federal District Court, Philadelphia. June 29: Supreme Court affirmed increase of the purchase price of N.H. by $28,000,000 to $174,000,000, 399 U.S. 392.			Mar. 2: Burlington Northern began operations upon merger of G.N., N.P., C.B. & Q. and subsidiaries.

Two applications, filed three months apart in 1959, began the restructuring of the East. In the *N&W/Virginian* case decided October 8, 1959,[8] the ICC authorized the merger of the Virginian into the N&W. The merger was effected on December 1, 1959 and thus reduced Eastern rail competition in the Pocohontas coal fields to the N&W and the C&O. The Virginian had been a friendly connection of the NYC. Its prospective unification with N&W likely influenced the first merger negotiations between the PRR and the NYC which began in November 1957. They were terminated by the NYC in January 1959.

The second 1959 application was approved by the ICC on September 13, 1960 in the *Erie-Lackawanna Merger* case.[9] The corporate unification of the Erie and the DL&W into Erie-Lackawanna Railroad Company was consummated on October 17, 1960, but the consolidation of forces and facilities was not effected until May 16, 1961.

Following the termination of merger negotiations with PRR in January 1959, the NYC first proposed an NYC-C&O-B&O alignment. Failing to negotiate C&O-NYC control of B&O, the NYC interests then entered into a contest with C&O for purchase of B&O stock. On June 14, 1960, the C&O filed its applications with the ICC for control of the B&O through acquisition of its capital stock. Shortly thereafter, the NYC also filed applications to acquire control of B&O, or, in the alternative, to participate jointly with C&O in the control of B&O. The contest continued, and by early 1961, the C&O was in a position to control at least 61 percent of the B&O stock. The NYC interests acquired a little more than 20 percent of B&O's voting stock or sufficient to prevent the C&O's filing of consolidated tax returns if eventually C&O acquired control of B&O.

Meanwhile, other plans to restructure the Eastern railroads were in process. Five applications, the first filed with the ICC on March 17, 1961, and the last on August 21, 1962, proposed to create an N&W system consisting of (a) the N&W as it then existed, (b) the Nickel Plate by merger with N&W, (c) the Wabash by lease and by control through stock ownership, (d) the Sandusky line by purchase from The Connecting Railway Company, a wholly owned subsidiary of the PRR system, (e) the AC&Y by control through stock ownership, and (f) the P&WV by lease.

The assent and participation of the PRR were necessary for presentation, approval and consummation of the proposal to create an expanded N&W system. PRR owned not only 87 percent of the outstanding Wabash voting stock but also 34 percent of the N&W stock then outstanding. N&W, a major coal carrying railroad, did not then have a port on lower Lake Erie for the transshipment of lake cargo traffic. Under the N&W merger plan, it would purchase from the PRR subsidiary the Sandusky line between Columbus and Sandusky, Ohio, and also port facilities at Sandusky and thus gain access to the lake. The Sandusky line also provided the necessary link between the west end of the N&W at Columbus and the Nickel Plate's main line at Bellevue, Ohio. The distances from Columbus over the Sandusky line are 108 miles to Sandusky and about 90 miles to Bellevue. In the *N&W Merger* case, the hearing examiner considered the Sandusky line to be "the key to the Norfolk & Western's proposed system." [10]

On September 21, 1961, the PRR's chief executive officer, while testifying in the *C&O–B&O* case, indicated that the PRR was willing to resume merger talks with NYC. He said that a merger of PRR and NYC would still make possible the formation of balanced competitive systems within the Northeast sector of the country and that in time, there would probably be three systems, Penn Central, C&O–B&O, and the N&W group. He referred merger to savings which NYC and PRR in their 1957–58 study agreed were in the neighborhood of $100 million annually.[11]

Facing the possibilities of a C&O–B&O coupling and a new N&W group and confronted with substantial net losses in the then current year 1961, NYC resumed merger negotiations with the PRR in late 1961. The result was the merger agreement approved by the Boards of Directors of the two companies

[8] Norfolk and Western Ry. Co. Merger, 307 I.C.C. 401 (1959).
[9] Erie R. Co. Merger, 312 I.C.C. 185 (1960).
[10] Norfolk & Western Ry. Co. and New York, C. & St. L. R. Co. Merger, 324 ICC 1, 83 (1964).
[11] The C&O–B&O case, 317 ICC.

on January 12, 1962, and signed on the same day. The application for ICC approval was filed March 9, 1962. Then there followed the tortuous administrative and court proceedings which finally resulted in the merger of Penn Central nearly six years later on February 1, 1968.

In a little less than nine years—from the filing of the N&W–Virginian application on April 6, 1959 to the merger of PRR and NYC on February 1, 1968—the Eastern rail system was almost completely realigned. The critical period of gestation appears to be the year 1962. A convenient date for reviewing the state of things at that time is April 1, 1962. The C&O–B&O control case was then awaiting the report of an ICC examiner. All the applications necessary for the new N&W system had been filed except the N&W–P&WV lease application, and it reached the Commission on August 21, 1962. The Penn Central proceeding was about to enter the hearing stage. The Government position was amorphous as the merger movement progressed rapidly. On April 4, 1962, the ICC approved the acquisition of control by PRR of the Lehigh Valley through stock ownership.[12]

The ferment of merger activity was generating wide interest in the numerous proposals for rail unifications not only in the East but also in the South and the West. In the South, Seaboard Airline and Atlantic Coast Line railroads were processing their application for merger.[13] In the West, an examiner was conducting hearings on the proposed unification of the so-called Northern Lines serving the northern tier states between the Great Lakes and the Pacific Northwest.[14]

On April 5, 1962, in his transportation message to the Congress, President Kennedy referred to the major mergers proposed in recent months in the railroad and airline industries. The President shortly appointed the Interagency Committee on Transport Mergers to develop general criteria applicable to rail and airline mergers for use by the Department of Justice in developing the Government's position on each merger application for presentation before the regulatory agencies. The Committee was composed of the Under Secretary of Commerce for Transportation as Chairman, the Chairman of the Council of Economic Advisers, the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, and the Assistant Secretary of Labor. The Committee issued its report stating general criteria in January 1963 while the Penn Central hearings were in progress.

In June and July 1962, the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary held hearings on a bill, the effect of which would have been to postpone until December 31, 1963 any railroad merger or control transaction involving more than $200 million in assets.[15] The bill would have applied to the proposed three systems in the East. No legislation resulted.

The merger process in the East continued to move rapidly in the latter half of 1962 and in 1963. The extensive Penn Central hearings before two ICC examiners began on August 20, 1962, and there was great opposition, although much of it was expressed as conditional support. The N&W merger proceeding was progressing through its later stages almost without opposition. The C&O's proposed control of B&O had an examiner's approval on May 1, 1962 and was awaiting the Commission's decision.

Throughout the Eastern unification cases, the ICC had before it petitions seeking consolidation of the several applications. The issue was first presented in *C&O–B&O*, the first of the major Eastern merger proceedings.[16] Several parties, including the Department of Justice, urged that the C&O–B&O proceeding be consolidated with the Penn Central and N&W merger cases. In its

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[12] Pennsylvania R. Co.—Control—Lehigh Valley R. Co., 317 I.C.C. 139 (1962).

[13] Seaboard Air Line R. Co.—Merger—Atlantic Coast Line, 320 I.C.C. 122 (1963), finally aff'd per curiam sub nom., Florida East Coast Ry. Co. v. United States, 386 U.S. 544 (1967).

[14] Great Northern Pacific & Burlington Lines, Inc.—Merger, etc.—Great Northern Ry. Co., 328 I.C.C. 460 (1966), (approval denied), 331 I.C.C. 228 (1967) (approval granted), 331 I.C.C. 895 (1968) (conditions modified), aff'd sub nom., Northern Lines Merger Cases, 396 U.S. 491 (1970).

[15] Hearings on S. 3097 before Subcom. on Rail Merger Legislation of Senate Committee on the Judiciary, 87th Cong., 2d. Sess. (1962).

[16] Chesapeake & O. Ry. Co.—Control—Baltimore & O. R. Co., 317 I.C.C. 261 (1962), aff'd per curiam sub nom. Brotherhood of Maintenance of Way Employees v. United States, 375 U.S. 216 (1963).

decision rendered December 17, 1962, the Commission refused to consolidate the proceedings or to withhold its determination of the C&O–B&O application.[17] It approved control by C&O of B&O through stock ownership subject to protective conditions for labor and competing carriers. Among the points discussed by the Commission were "the poor financial condition of B&O", "that B&O's properties are in dire need of rehabilitation", "that B&O's financial condition will ultimately be strengthened as the result of the proposed modernization plan", and "the complete inability of B&O by itself to improve its financial position." [18]

Three of the 11 ICC commissioners voted against the C&O–B&O approval. At the root of Commissioner Tucker's long dissenting opinion was the contention that the Commission with unnecessary haste and without adequate inquiry was taking an irretrievable first step toward approval of a far-reaching realignment of the Eastern railroad system.[19] Reviewing the extensive evidence, Commissioner Tucker found a distinct probability of significant diversion of traffic from NYC to C&O–B&O as a result of approval of the new system.[20]

The ICC's refusal to consolidate the C&O–B&O, Penn Central and N&W cases came to the courts on the appeal by the labor unions of the ICC's approval of the C&O–B&O control in 1963. Before the three judge district court, the Department of Justice strongly urged that the Commission failed to make adequate findings concerning the impact of the proposed C&O–B&O control upon other railroads in the East, upon the two pending Eastern merger proposals (N&W and Penn Central) and hence upon the future structure of the Eastern railroad industry. It argued that the Commission's finding that the N&W and PRR–NYC merger proposals were irrelevant to the C&O–B&O case, amounted to a failure to come to grips with the most significant issue of the proposed acquisition—the future structure of the Eastern railroad industry.[21] The labor unions made a similar contention. The court affirmed the Commission's approval.

The unions then appealed to the Supreme Court. In their jurisdictional statements, they referred to the ICC's "closed mind" and attacked its refusal to consolidate the interrelated applications. They emphasized that the outcome of the case was of vital importance in the reshaping of the entire railroad system in the Eastern part of the country. On motion of the Commission and C&O–B&O, the Supreme Court on December 9, 1963 affirmed the decision of the district court dismissing the appeal from the Commission's order of approval.[22]

The consolidation issue remained throughout the Eastern merger proceedings.[23] To be sure, the consolidation of the cases for hearing appeared neither feasible nor necessary. The Penn Central applications had 128 days of hearing over the period August 20, 1962 through October 2, 1963 in 18 cities in nine states extending from Boston to St. Louis. A huge record of oral and written testimony and exhibits was made. More than 200 parties intervened initially, and these included states and their subdivisions, rail and other for-hire carriers, shippers and trade associations, labor organizations, and the Department of Justice. At the conclusion of the hearings, the protests against the merger were extensive. Among the most aggressive protestants were the labor interests supported by the Department of Justice although it offered no evidence in the proceeding.

On the day before the hearings ended, October 1, 1963, an assistant attorney general of the United States presented a prepared statement of opposition to the proposed merger. He also stated that the United States would not oppose the N&W–NKP–Wabash unification applications then in their final

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[17] Id. at 263–66.
[18] Id. at 266, 275, 279.
[19] Id. at 296, 318–26.
[20] Id. at 326.
[21] See brief for United States to Federal district court for Eastern District of Michigan in Brotherhood of Maintenance of Way Employees v. United States, Civil Action No. 23467 (April 1963), 221 F. Supp. 19 (E.D. Mich. 1964).
[22] Brotherhood of Maintenance of Way Employees v. United States, 375 U.S. 216 (1963).
[23] Petitions for consolidation of then pending Eastern unification cases were filed as late as April 1967 by the Reading Railroad and May 1967 by the Trustees of Central Railroad of New Jersey. Both railroads are now in § 77 reorganizations.

stages before the Commission, or the C&O–B&O control which the labor interests were in the course of appealing to the Supreme Court.[24]

Throughout 1963, the managements of PRR and NYC were facing serious opposition to the merger and probably long and costly delays. PRR's chief executive officer, James M. Symes, was then beyond the retirement age of 65, and his replacement was under consideration. For the first time in over a century, the Board of Directors of PRR elected as its head an executive who had not come up through the PRR ranks. The new chairman and chief executive officer, Stuart T. Saunders, took office October 1, 1963.

As president of N&W in the previous five years, Saunders had seen the merger of N&W and the Virginian in 1959, and had worked out the then pending N&W-NKP-Wabash unification. It was virtually unopposed and headed for ICC approval. In less than one year after Saunders took over as PRR's chief executive officer, the extensive opposition to the Penn Central merger was greatly reduced. States and their subdivisions withdrew or modified their opposition. With the joinder of NYC's President Perlman, Saunders worked with the protesting labor unions. On May 20, 1964, PRR and NYC entered into the so-called attrition agreement with 17 labor organizations. This agreement was later extended to cover a total of 23 unions. With major labor opposition thus satisfied, the merger partners next neutralized the Department of Justice objections, apparently at the price of agreeing to include the New Haven in the proposed merger.[25] However, the opposition of Milton J. Shapp, now Governor of Pennsylvania, and a labor group designated the Pennsylvania Labor Interests, continued throughout the Penn Central proceedings.

Shortly after the May 20, 1964 agreement between PRR/NYC and the labor unions, the ICC on June 24, 1964 approved the N&W unification in the *N&W Merger* case.[26] Two conditions of approval require comment here:

First, the Commission provided that for a period of five years, it would retain jurisdiction to permit the filing of petitions by EL, D&H and B&M for inclusion in the N&W system.[27] EL originally opposed the applications but then changed to support when it obtained an agreement from N&W that upon approval of the N&W-NKP merger, N&W would enter into negotiations with EL in an attempt to agree upon some form of affiliation with EL. In its decision, the Commission, in effect, extended the benefits of this agreement to D&H and B&M.

Second, as stated above, the PRR held substantial stock ownership in N&W and Wabash. In the *N&W Merger* decision, the Commission required that the Pennsylvania system divest itself of its then or thereafter acquired holdings of stock of N&W and Wabash within ten years after the N&W–NKP–Wabash unification and that all management relationships between PRR and N&W be severed within 60 days after the N&W unification.[28] If the PRR failed to agree to the divesture condition, then the proposed N&W–NKP–Wabash merger could not be consummated. Pending divestiture, PRR was required to put the voting rights of the N&W stock in three independent trustees. The Wabash stock was not required to be trusteed.[29]

Thus PRR for the second time was in a position to determine the structure of railroads in the East. As stated above, its assent was essential to the original proposal for the new N&W system as evidenced, for example, by its willingness to sell to the N&W the Sandusky line, a necessary link for efficient operation of the new system. PRR faced the critical uncertainty: would its proposed merger with NYC be approved? The record in the Penn Central merger case was closed, and with labor and other opposition diminishing in force or disappearing, the prospects of approval were improving. Moreover, the financial and tax features of its divestment appeared to present no insurmountable barrier. PRR assented to the divestiture condition. The new N&W system began operation on October 15, 1964.

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[24] Penn Central transcript of testimony, Oct. 1, 1963, pages 19,416ff.

[25] See the later discussion at page 328 concerning the PRR/NYC meetings with officials of the Department of Justice in 1964 and 1965.

[26] Norfolk & Western Ry. Co. and New York, C. & St. L. R. Co. Merger, 324 I.C.C. 1 (1964).

[27] Id. at 27–33, 148.

[28] Id. at 41–49.

[29] Id. at 44, 49.

Thus in less than two years, two new rail systems were created in the East, C&O–B&O in 1963 and the N&W formation in 1964. Interestingly, in the *N&W Merger* case, the ICC said, "We are not, in this proceeding, restructuring the railroads in the East." [30] It was convinced that the delay of its N&W merger decision until determination of the Penn Central case "may endanger, or defeat entirely, the unification which the evidence here of record establishes beyond question to be in the public interest." [31]

Whatever the risks of consent to creation of the N&W system at that time, PRR and NYC were about to face many complications. Up to the time of the N&W–NKP–Wabash consummation in 1964, little opposition to the unification applications came from other railroads. Once the three-system East became a minimum forecast of the Eastern railroad structure, the tempo of the PRR/NYC merger litigation increased, and delays followed.

The record in Penn Central was reopened for the limited further hearing on labor matters held on September 16, 1964. C&O–B&O had been functioning since February 1963, and the new N&W system began operations on October 15, 1964. The smaller lines obviously had to consider their position in the emerging three systems. EL had withdrawn from the *N&W Merger* case with the assurance that it could return for inclusion within five years. The requests of D&H and B&M for inclusion in that system had been denied without prejudice. New Haven, in reorganization since July 7, 1961, requested inclusion in Penn Central in June 1962 and was holding fast to its request. At the outset, applicants were adamantly opposed to taking in the New Haven. However, in their initial brief filed July 1, 1964, PRR/NYC still opposed the New Haven's request, but proposed three alternatives if the Commission found the New Haven inclusion to be in the public interest. One would require PC to contract to operate only the freight service of the New Haven.

On March 29, 1965, in *Penn Central*, the examiners issued a comprehensive report proposing approval of the proposed merger substantially on the terms and conditions proposed by applicants.[32] A later section of this report will consider the conditions proposed by the examiners and ultimately imposed by the Commission. Viewed from the lofty heights of hindsight, the treatment of the inclusion of the New Haven was critical. Believing "that the operations of New Haven would impose a persistent and substantial burden upon the merged company", the examiners required the merged company to assume the burden of providing only freight service over the NH's lines. They recognized the need for a further hearing to determine the exact method and terms of inclusion.[33]

The examiners temporized with the inclusion requests of EL, D&H and B&M and left the way open for later renewal of their requests to be brought within the PC system if their preferred inclusion in the N&W was denied.[34] The three railroads reacted. In September 1965, each filed a petition for inclusion in the newly created N&W system. For our purpose here, we need not review the details of those inclusion proceedings. They were ultimately concluded over two years later by the Supreme Court's decision approving the Penn Central merger and the inclusion of EL, D&H and B&M in the N&W system.[35]

By late 1964, the PRR had trusteed its N&W stock and satisfied the management separation requirements of the ICC's order approving the N&W merger. Meanwhile, a new merger was being planned. On October 11, 1965, N&W and C&O filed an application with the ICC for approval of the merger of C&O into N&W to form a new N&W–C&O system roughly equal to the proposed Penn Central in market coverage, miles of road, annual revenues and other characteristics.

Thus at year's end in 1965, three major Eastern unification cases were pending before the ICC. The PRR/NYC merger was in the final procedural stages before decision by the Commission. The N&W merger case was reopened

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[30] Id. at 31.
[31] Id. at 18.
[32] Their report is reprinted almost in full in Pennsylvania R. Co.—Merger—New York Central R. Co., 327 I.C.C. 475, 566–1072 (1966).
[33] Penn Central case, 327 I.C.C. at 842–70, 921–22, 947–8.
[34] Id. at 925–27.
[35] Penn Central Merger and N&W Inclusion Cases, 389 U.S. 486 (1968).

for further hearing to consider the petitions of EL, D&H and B&M for inclusion. The N&W-C&O merger case was in its initial stages.[36]

Finally, on April 27, 1966, the ICC approved the Penn Central merger.[37] Relying on applicants' evidence showing their declining financial situation since 1952, the prospect of savings of $80 million annually, and the plans for a malgamating their lines and improving service, the Commission rejected contentions asserting serious anticompetitive effects of the proposed merger.[38] On the other hand, it gave careful attention to the inclusion of other railroads in the proposed transaction.[39] It again rejected requests for consolidation of the Eastern unification proceedings for decision, specifically, joining the Penn Central merger application with the *N&W Inclusion* case.[40] But believing that immediate creation of Penn Central might divert substantial traffic from EL, D&H and B&M, the Commission prescribed, as a condition of approval, a novel provision under which Penn Central would make payment of indemnity for losses of revenue suffered by the protected railroad under a formula prescribed in the report.[41] Those protected railroads were to await the outcome of the *N&W Inclusion* case in which they had inclusion petitions pending.

As to the New Haven, however, the Commission required the complete inclusion of New Haven and directed the parties to submit a plan for inclusion of both New Haven freight and passenger service. The Commission commented that "The applicants are not averse to including NH's freight service in the merged systems and have already reached an agreement with NH's trustees for doing so." [42] We should note that on the same day as the merger decision, the ICC authorized New Haven to discontinue approximately 50 percent of New Haven's long haul or through passenger service.[43]

After the merger decision on April 5, 1966, nearly two years were consumed in court tests of the prospective Penn Central merger and in the determination of the *N&W Inclusion* case and related questions. The Commission reconsidered its original order of approval, substantially affirmed it on September 16, 1966, but reopened the proceeding for reconsideration of the provision for indemnification of EL, D&H and B&M.[44] Contemporaneously the Commission was determining the petitions of those three railroads for inclusion in the N&W system.

Meanwhile, six appeals were taken to the courts from the original merger approval of April 6, 1966. The Supreme Court on March 27, 1967 remanded the case to the ICC.[45] The Court found it necessary that the decision as to the future of EL, D&H and B&M and their inclusion in a major system be made prior to consummation of the PC merger. The Court specifically did not pass on the validity of the merger. Pointing out that the proceedings could be expedited and an early determination made of the inclusion questions, the Court did not believe that the postponement

> . . . is too high a price to pay to make as certain as human ingenuity can devise, a just and reasonable disposition of this matter for all of the parties. After all, it is the largest railroad merger in our history and if not handled properly could seriously disrupt and irreparably injure the entire railroad system in the north-eastern section of the country—to the great detriment not only of the parties here but to the public convenience and necessity of the entire Nation.[46]

A few days more than two months later, on June 9, 1967, the ICC ordered the inclusion of EL, D&H and B&M in the N&W system, modified and rein-

[36] After the Penn Central collapse, N&W and C&O withdrew their merger application, and the proceeding was dismissed on April 22, 1971. An examiner had recommended approval of the merger.
[37] Pennsylvania R. Co.—Merger—New York Central R. Co., 327 I.C.C. 475 (1966) (initial report), 328 I.C.C. 304 (1966) (reconsideration), 330 I.C.C. 328 (1967) (supplemental report after further hearing on Appendix G conditions and capital loss and indemnification). The later reports dealing with the New Haven inclusion are 331 I.C.C. 643 (1967) (second supplemental report), 331 I.C.C. 754 (1968) (third supplemental report), and 334 I.C.C. 25 (1968) (fourth supplemental report).
[38] Penn Central initial report, 327 I.C.C. 481 and 697 ff.
[39] Id. at 521-37.
[40] Id. at 531.
[41] Id. at 532-34.
[42] Id. at 523, 475, 526-27, 553.
[43] Id. at 525; New York, N.H. & H.R. Co., Discontinuance of Trains, 327 I.C.C. 151 (1966). The New Haven did not utilize the authority and discontinue the trains.
[44] The report on reconsideration is Pennsylvania R. Co.—Merger—New York Central R. Co., 328 I.C.C. 304 (1966).
[45] Baltimore & Ohio R. Co. v. United States, 386 U.S. 372 (1967).
[46] Id. at 392.

stated the indemnity provisions for protection of those railroads pending their inclusion in a system, and authorized the consummation of the PC merger at the earliest possible date.[47] The Commission adverted to the substantial decline in the earnings of the Eastern railroads including PRR and NYC, the latter showing a deficit of $2 million in its operations in the first quarter of 1967.

The Commission's decisions were promptly appealed and quickly reached the Supreme Court. On January 15, 1968, the Court affirmed the ICC's orders approving the Penn Central merger and requiring inclusion of EL, D&H and B&M in the N&W system.[48] Noting the minimal attacks on the merger itself, the Court nevertheless reviewed the basic merits of the proposed PC union and found no basis for reversing the ICC's public interest conclusions and approval. The Commission had rejected an effort of certain New Haven bondholders to have the NH simultaneously included in the merger because of the Commission's failure to require PC to absorb all the losses of NH pending agreement for inclusion. N&W, C&O-B&O and others, though not objecting to the approval of the PC merger, opposed its immediate consummation on several grounds related to the inclusion of EL, D&H and B&M in a larger system. The Court rejected the positions of the NH bondholders and of appellants N&W, C&O and others. In the *N&W Inclusion* case, the appeals related to details of the ICC's inclusion order were also dismissed.

On February 1, 1968, nearly six years after the Penn Central application was filed with the ICC, PRR and NYC merged. Two years of merger were disastrous. In the spring of 1970, the crises became acute. On June 21, 1970, Penn Central sought reorganization under § 77 of the Bankruptcy Act in the Federal District Court at Philadelphia.

Managing the Merger: Pivotal Figures

Pivotal figures in the development of the plan and execution of the Penn Central merger were James M. Symes, president of PRR from 1954 to 1959 and its chairman and chief executive officer from 1959 until his retirement on September 30, 1963 in the midst of the Penn Central proceedings; Alfred E. Perlman, president of NYC from 1954 to February 1, 1968 (Merger Day) and Penn Central's president and chief administrative officer from Merger Day to December 1, 1969; and Stuart T. Saunders, N&W's president from 1958 to October 1, 1963, PRR's president and chief executive officer and PC's chairman and chief executive officer from that date to June 8, 1970.

Perlman had long been in railroading primarily on the operating side. After spending 18 years in rehabilitating and modernizing the Denver and Rio Grande Railroad, he came to NYC as its president in 1954 with no illusions about its physical and financial problems. He undertook to solve those problems. Long-term debt was reduced by a net amount of almost $200 million in the five years preceding the Penn Central hearings in 1963. Physical plant was modernized through capital investment of $390 million. Among other things, the main line was improved between Chicago and New York; four modern electronic yards were built; and an extensive research program was undertaken. The new facilities not only eliminated 60 antiquated yards but also improved service.

In his testimony in the merger case, Perlman said that, if the improvements had not been made, NYC, would long since have been in reorganization. On the other hand, NYC revenues continued to decline. He pointed out that NYC earned net railway operating income sufficient to meet its fixed charges in only two years in the period 1955–62. There is, he asserted, an excess of rail capacity in Eastern Territory. He attested that if the Commission approved both the C&O–B&O and the N&W merger applications, NYC could not compete alone against the traffic strength of the two new systems. With the divestiture of PRR's interest in N&W, he urged approval of the PRR/NYC merger and called it the keystone of the establishment of three balanced competitive systems in the East.[49]

On the PRR side, two men, Symes and Saunders, dominated the planning and execution of the merger. In 1954, after climbing up the PRR managerial ladder, Symes began a critical decade of service as the head of a railroad highly

[47] Norfolk & Western Ry. Co. and New York, C. & St. L. R. Co. Merger, 330 I.C.C. 780 (1967); Pennsylvania R. Co.—Merger—New York Central R. Co., 330 I.C.C. 328 (1967) (first supplemental report).
[48] Penn Central Merger and N&W Inclusion Cases, 389 U.S. 486 (1968).
[49] Transcript of Perlman's testimony in Penn Central case, pp. 980–1014 and especially pp. 981–83, 990–94, 1006.

successful over the years, but at that time in a period of uncertain transition. With PRR facing declining profits and frequent losses from its railroad operations, he undertook numerous courses of action to improve the situation. Illustrative of the efforts to improve or retain revenues, on the one hand, and, on the other, to reduce expenses are the following:

In 1952, with the cooperation of General Motors, Symes led PRR into an extensive program for the development of trailer-on-flatcar (piggyback) service. To stem the decline of coal traffic, an essential segment of PRR's business, fields in Pennsylvania among its extensive holdings were marked for development. PRR also undertook a plan of plant improvement which included, for example, the construction of a new $30 million facility at Conway, Pa., near Pittsburgh. Centrally located on the PRR system, Conway at completion was the largest classification yard in the East.

To bring expenses in line, Symes ordered strict austerity in the operations, a measure familiar to the railroad since the Depression of the 1930's during which PRR operated without a single loss year. Work began on a system of responsibility accounting which permitted increased autonomy to the regions but held them strictly accountable for results. By the time of the merger in 1968, the system was a settled part of the PRR's procedure.

Symes recognized the signs of weakness, and they continued into the late 1950's. PRR had long invested in areas generally related in some way to transportation and was considered one of the richest railroads of the Nation. It held as much as 44 percent of the outstanding voting stock of N&W and was the owner of almost all the stock of the Wabash. In close touch with PRR's prestigious Board of Directors and particularly its Executive Committee, Symes reviewed the Eastern railroad situation and determined a course of action without a formal study of the long and short range prospects of the Eastern railroads as a group, PRR's operations as a railroad, or its unification with various merger partners. In the 1930's, as a member of the staff of the Federal Coordinator of Transportation, he had participated in the studies leading up to the so-called Prince Plan of unifying the railroads in the United States into a limited number of systems. Later he also directed a study looking to coordination of rail terminal operations in the complex Port of New York area.

Numerous options were available to PRR. Its unification with B&O had frequently been mentioned. N&W and Wabash were regarded as members of the PRR family. In the 1950–59 period, the prices of their common stock were in the range of 11½ to 30⅝ for PRR and 39⅝ to 108 for N&W. Concentrated in the Pocahontas coal fields, N&W, the crown jewel of PRR's numerous investments, was highly profitable and efficiently operated. The Wabash appeared disposable; it added little to the PRR system except for the lines extending west of the Mississippi to Kansas City, Omaha and Des Moines.

The one merger rarely if ever considered was joining the arch rivals, PRR and NYC. Symes believed that this union had huge potential for savings. West of New York City to the Pittsburgh and Buffalo areas, though their lines were roughly parallel but miles apart, they served different areas, PRR being dominant in the Pennsylvania-New Jersey-Maryland sector and NYC in the populous New York state area. Both were highly competitive in the Pittsburgh-Youngstown-Cleveland manufacturing corridor. West of Pittsburgh and west of Buffalo, the two railroads reached substantially the same major markets such as Chicago, Detroit, Cincinnati and St. Louis.

With the approval of the PRR Board of Directors, in the fall of 1957, Symes first approached Robert R. Young, then chairman of NYC's Board, and shortly thereafter discussed the subject with Young and Perlman. Merger studies were initiated in November 1957 and are said to have then indicated annual savings of about $100 million. However, the parties were unable to agree on an exchange ratio for the PRR and NYC stock and were considering whether outside appraisers should be brought in. Negotiations were terminated in January 1959.

In the ensuing months, NYC turned its effort in other directions. These culminated in its intervention in the C&O–B&O case in June 1960 and in the later filing of its applications to acquire control of the B&O jointly with C&O. NYC had engaged in a contest with C&O for purchase of B&O stock. NYC

interests ultimately held more than 20 percent of the B&O's voting stock. The C&O had assents from holders of over 60 percent of the total B&O shares.[50] The ICC consolidated the NYC applications with the C&O applications filed a few months before, and the combined cases were being heard in 1961.

Symes, still hopeful of a PRR–NYC merger, testified in September 1961 in the C&O–B&O–NYC hearings in rebuttal to Perlman's testimony concerning a balanced competitive system in the East. Asked whether NYC would be left out in the cold in the Eastern merger picture and would eventually be unable to survive, Symes commented that the merger door was not closed if NYC wanted to reopen it. In fact, Symes helped to open the door again by arranging meetings between the chief executives of NYC and C&O. Late in 1961, NYC agreed to sell its B&O holdings to C&O, withdrew from the C&O–B&O case,[50a] and resumed negotiations with the PRR. These further negotiations resulted in the PRR–NYC joint agreement of merger which was dated January 12, 1962 and was signed by all directors of PRR and NYC including Symes, Perlman and those directors constituting the two three-man merger committees of each board.

The merger application, filed March 9, 1962, encountered many difficulties. Throughout the merger hearings extending from August 20, 1962 to October 2, 1963, PRR and NYC as applicants steadfastly adhered to two points of particular significance later in the proceedings. They were agreeable to the imposition of the usual provisions prescribed by the ICC for the protection of labor. They opposed any condition requiring the inclusion of New Haven. Symes testified that if the ICC attached such a condition to its approval, he would submit the condition to PRR's Board of Directors for decision, but would recommend against acceptance of merger approval subject to this condition.

While the C&O–B&O–NYC matter was being resolved, a second new system was being formed around N&W. Symes and three other PRR representatives were on the N&W board. As first announced, the N&W plan included only merger with the NKP. Symes has stated that the PRR then insisted on the inclusion of the Wabash as a condition for PRR's voting of its stock in favor of the N&W–NKP unification. The so-called Sandusky line between Columbus and Sandusky, Ohio, was then owned by a PRR subsidiary. That line was necessary to join the lines of N&W and NKP; the connection between N&W and Wabash would be via the Sandusky line and the NKP.

As finally presented to the ICC in the applications initially filed March 17, 1961, the N&W proposal included both NKP by merger and Wabash by purchase of stock for PRR or by lease and, perhaps of equal importance, the purchase of the Sandusky line from the PRR subsidiary. The purchase price approved for the Sandusky line was $27 million or about $2 million less than $29.2 million representing reproduction costs less depreciation.

The N&W–NKP–Wabash applications, as originally filed, proceeded to hearing in 1963, but there were complications. Two relatively short railroads, the P&WV operating in the Pittsburgh district and the AC&Y running west from Akron, Ohio, were primarily overhead carriers hauling freight between their interchanges with connecting railroads. They depended on their connections with NKP for substantial traffic. Negotiations finally resulted in agreements for their inclusion in the proposed N&W system, applications were filed, and the procedure rapidly completed. In fact, the new N&W System as submitted was approved by the ICC on June 24, 1964, several months before the last day of hearing on the PC applications in September 1964.

By that time, important changes in management had occurred. Saunders became president of N&W in 1958. The N&W-Virginian merger in 1959 was

[50] C&O–B&O case, 317 I.C.C. at 267, 284 (1962).

[50a] By order dated January 29, 1962, the ICC authorized NYC to withdraw from the case and dismissed its application to control B&O. 317 I.C.C. at 262. During the weekend of February 17–18, 1962, Messrs. Tuohy (President of C&O), Perlman, Saunders (then President of N&W) and Symes met in Palm Beach, Fla. to discuss various matters pertaining to the Eastern merger situation. In a memorandum dated February 20, 1962, Symes recorded that the big question considered at the weekend meeting was the NYC and Alleghany Corporation holdings of Baltimore and Ohio common stock (about 560,000 shares or slightly in excess of 20 percent of the total outstanding) on their books at approximately $24 million. These holdings, if transferred to C&O, would enable C&O to hold just a little over 80 percent and receive the benefit of tax savings through a consolidated tax statement. After many arguments on the subject over several days, Symes stated it was finally agreed (subject to approval by the boards of C&O, NYC and Alleghany) that NYC and Alleghany would dispose of their B&O holdings to C&O at the cost of the B&O stock to them (approximately $24 million).

finalized in his administration as was the building of the N&W system in the expanded form approved in 1964. The details of the building included critical matters such as the several attrition agreements made with the labor unions which assured no substantial labor opposition, the inclusion arrangements with EL under which EL withdrew its opposition and supported the applications, and the inclusion of P&WV and AC&Y described above. Saunders was party to the 1962 meetings leading to the agreement terminating the C&O–NYC fight over B&O. He was, in short, experienced in the merger game.

Highly recommended by Symes, Saunders was elected chairman of the board and chief executive officer of PRR and took office on October 1, 1963. On the same day, at the ICC hearings, the Department of Justice presented a statement in opposition to the Penn Central merger. Hearings on the case were completed the following day, October 2, and there was serious opposition from many sectors. The prospect of success was bleak.

Nearly 18 months later, on March 29, 1965, the hearing examiners recommended approval of the Penn Central merger. By that time, a superbly planned and executed campaign led by Saunders and Perlman had reached most of the parties protesting the merger. Important opposition became inactive, was withdrawn or was modified so as to seek approval conditions. The states of Connecticut, Massachusetts, Rhode Island and New York, and certain labor groups advocated inclusion of the New Haven's passenger as well as its freight service; the Commonwealth of Pennsylvania did not oppose, but sought treatment of secondary adverse results of the merger; and communities in Pennsylvania such as Pittsburgh, Philadelphia, New Castle and Ambridge, no longer objected to the merger. The missionary work sometimes had troublesome repercussions; Saunders' address on December 16, 1965, at New Castle, Pa., for example, upon which protester Shapp relied in his futile attempt to reopen the merger case.

In effect, the campaign substantially eliminated state and community protests. Of equal and greater importance were the measures taken to placate the labor opposition and to change the Department of Justice's position from opposition to support. Saunders as N&W's president had reached an accord with labor in the *N&W Merger* case. Now he as PRR's chairman and Perlman as NYC president undertook negotiations with the major labor groups. On May 20, 1964 and thereafter, PRR and NYC entered into the so-called Luna-Saunders attrition agreement with 23 unions representing 77,000 employees or about 75 percent of applicants' labor force. The agreement ended national labor's opposition to the merger.

Though closely allied for several years, Saunders and Symes were not close after Saunders became the PRR's chief executive officer on October 1, 1963. Symes continued as a member of the board of directors for two periods of time prior to the merger. He did not approve of the labor attrition agreement nor of the inclusion of the New Haven. He is said to have opposed both at meetings of the board. Perlman, the other architect of the merger, had also been adamantly opposed to the New Haven inclusion. Yet on June 1, 1964, NYC joined in applicants' opening brief stating their willingness to enter into a contract to operate the New Haven's freight service.

The Department of Justice in its June 1, 1964 brief continued to oppose the merger on its merits. As it turned out, its opposition and the New Haven problem were handled together: [51]

A conference to discuss the Government's opposition to the merger was arranged for August 24, 1964, in the office of Attorney General Robert F. Kennedy in Washington. Saunders, Perlman and George Leighty, Chairman of the Railway Labor Executives' Association, met with Mr. Kennedy, Nicholas deB. Katzenbach, Deputy Attorney General, and William H. Orrick, Jr., Assistant Attorney General in charge of the antitrust division. Saunders and Perlman explained in detail why the Penn Central merger was necessary to the survival of their railroads. They reasserted their previously asserted

[51] The following discussion of conferences between PRR, NYC and the Department of Justice is based on Mr. Katzenbach's letter of Sept. 4, 1964, to Saunders to which is attached Mr. Robert Kennedy's memorandum of Sept. 3, 1964; Saunders' reply of Sept. 9, 1964 to Katzenbach, Saunders letters of Jan. 14, 1965 to Katzenbach, of Jan. 14, 1965 to Mr. Orrick, and of Apr. 22, 1965 to Katzenbach, see Appendix D, Exhibit 67, p. 714.

willingness to cooperate with the Department or the ICC in assuring that transportation services would continue to be rendered by the New Haven and that its services would not be impaired by the Penn Central merger. Saunders referred to the ICC's decision of June 24, 1964, approving the proposed N&W merger subject to divestiture by PRR of its N&W stock. He indicated that the Government's attitude on the pending Penn Central merger would have an influence on the PRR's important decision as to divestiture.

After considerable discussion, the Attorney General pointed out that his further tenure in office would be quite brief and that he could make no commitment binding his successor. Circumstances, he said, made it inappropriate to take any action at that time contrary to the position of opposition stated in the Department's June 1964 brief to the ICC.

On the other hand, Mr. Kennedy said that he would, by memorandum, inform his successor of his recommendation along the following line: If the hearing examiners' decision should be favorable to the merger and the merger applicants had by that time formulated terms for the New Haven's inclusion satisfactory to the New Haven's trustees and the Distiict Court, he would recommend that the Department discontinue its opposition to the Penn Central merger unless circumstances had materially changed. Saunders indicated that this information would be helpful to him and the PRR board of directors in reaching a decision on the divestiture question.

On September 4, 1964, Mr. Katzenbach, as Acting Attorney General, transmitted the promised Kennedy memorandum to Saunders and expressed agreement with Mr. Kennedy's conclusions. A few days later, in a clarifying letter to Mr. Katzenbach, Saunders referred to an agreement that the merger applicants would diligently seek to find a fair and reasonable basis to include the New Haven in the proposed Penn Central system. As he understood the situation, inclusion was not to be an absolute condition to withdrawal of the Department's opposition to the merger, and the inclusion action did not necessarily have to be taken prior to the examiners' report.

On January 8, 1965, Saunders and Perlman again met in the Attorney General's office with Attorney General Katzenbach and Mr. Orrick and informed them about the then pending negotiations with the New Haven. Mr. Katzenbach reconfirmed the Government's position stated in the September 1964 correspondence. On April 19, 1965, after issuance of the examiners' proposed report approving the merger, they again met and reviewed the current status.

Several days later, on April 22, 1965, Saunders wrote the Attorney General about a memorandum of understanding between the merger applicants and the NH trustees for the inclusion of the New Haven in Penn Central and outlined how, in their NH agreements and negotiations, the applicants were complying with the Kennedy memorandum with which Mr. Katzenbach was in agreement. Based on the understanding reached with the Department, Saunders said, the PRR had agreed to divest itself of its N&W and Wabash stock as required by the approval conditions in the *N&W Merger* case.

Pivotal figures in the merger picture were thus turning the view from defeat to success. ICC Commissioner Tucker, a New Englander with a natural interest in the New Haven, reflected the change. He dissented at length from the Commission's authorization of the C&O–B&O control in 1962 and voted against the N&W merger approval in 1964. In the Penn Central decision in 1966, he concurred without qualification in the approval of the merger. He spoke of the risk of leaving PRR and NYC separately to face the powerful competition of the two new systems, C&O–B&O and N&W. In his judgment, the New Haven Railroad problem had to be given very substantial weight, and the proposed merger presented an opportunity to assist in the revitalization of the New Haven's rail operations.[52]

Pivotal figures in the two merger partners had persevered. The work of accommodation was largely done by the time of the ICC's initial decision on April 6, 1966. The work of physical planning for merger, discussed later in this report, had the benefit of time provided by the delays of litigation. The con-

[52] Initial Penn Central decision, 327 I.C.C. at 548–51.

troversies subsequent to the initial decision related principally to the conditions of approval reviewed in the next subsection.

The first appeal to the Supreme Court in 1967 reflected little opposition to the merger on the merits. In the second appeal approving the merger, the Court in January 1968 noted the general accord among the parties before it that the merger was in the public interest. Among those listed by the Court as urging immediate consummation of the merger were the ICC, the Department of Justice, the Railway Labor Executives Association, six Eastern states and the New Haven trustees.[53]

The Conditions of Approval Imposed by the ICC

The Interstate Commerce Commission attached numerous conditions to its approval of the Penn Central merger. Viewing the surge of railroad unifications in the 1960–69 decade, many observers evaluate the ICC's role as passive. It approved all the major unifications presented for its approval. Its main concern appeared to be the protection or inclusion of other railroads in the territories involved, and such was its approach in the *Penn Central* case.

INCLUSION OF OTHER RAILROADS

In the initial proceedings, New Haven, Erie-Lackawanna, Delaware and Hudson, Boston and Maine, New York, Susquehanna and Western (NYS&W), and Brooklyn Eastern District Terminal (BEDT) sought inclusion in Penn Central. EL, D&H and B&M were ultimately designated for the N&W system. EL became a separate part of that system on April 1, 1968. D&H came into the N&W family in July 1968. The B&M rejected inclusion in N&W in May 1969 and one year later went into reorganization under § 77 of the Bankruptcy Act where it is still continuing.

BEDT, a terminal carrier connecting with all railroads serving the port of New York, operates rail and car float facilities in the port area. It asserted prospective diversion of traffic growing out of the PRR's ownership of the Long Island Railroad. BEDT suffered annual deficits averaging about $90,000 on revenues of $2.1 million in the years 1961–63. The Examiners recommended denial of immediate inclusion of BEDT. The Long Island was sold by PRR to the state of New York prior to the Commission's initial report. Nonetheless the Commission made provisions for the inclusion of BEDT in Penn Central, BEDT has thus far made no proposal, and the matter is dormant.[54]

NYS&W, a railroad operating 70 miles of track all within New Jersey, sought inclusion in PC by petition filed October 12, 1962. It was incurring annual operating deficits in excess of $300,000, most of which resulted from commuter service. In the initial decision, the Commission required inclusion of NYS&W under terms and conditions to be agreed upon by the parties and, failing agreement, to be fixed by the Commission. The parties failed to reach an agreement, but nothing further has transpired.[55]

Inclusion of the insolvent New Haven was crucial to the approval of the Penn Central merger by the ICC. The inclusion appears also to be a major factor in the insolvency of the merged company. The NH trustees presented their petition for inclusion on June 26, 1962, and thereafter stood firm until NH was included in PC on December 31, 1968.[56]

New Haven had been in reorganization since early 1961. At the PC hearings, it did not ask for inclusion of its passenger service and presented no evidence of adverse effect on that service. In the five year period 1959–63, its passenger deficit ranged from a low of $8.6 million in 1963 to a high of $13.3 million in 1960. On the freight side, the high and low in that period were net income of $3.5 million in 1959 and deficit of $7.2 million in 1961, respectively.

In their Penn Central report, the examiners recommended inclusion of New Haven freight service only,[57] but in its several decisions, the Commission

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[53] Penn Central Merger case, 389 U.S. at 498.
[54] Initial Penn Central decision, 327 I.C.C. at 488, 534, 552, 889, 1062.
[55] Id. at 552, 903.
[56] The New Haven situation is fully reviewed in New Haven Inclusion Cases, 399 U.S. 392 (1970).
[57] Id. at 842–70, 922–23.

not only required unlimited inclusion but also made provisions to keep NH alive pending inclusion.[58] The initial decision relied on the Commission's contemporary decision authorizing NH to discontinue about 50 percent of its long haul passenger schedules. This action, the Commission said, was only the beginning toward sound restructuring of NH. In fact, New Haven did not discontinue the trains in question as authorized by the Commission.

Tottering on the edge of total cessation of operations, New Haven managed to survive until inclusion. The dispute finally was reduced to the price to be paid by PC for the NH properties. The inclusion became a two-step affair when on November 25, 1968, under prodding of the reorganization court, the ICC ordered Penn Central to take over the New Haven properties by January 1, 1969.[59] PC took over December 31, 1968, or 11 months after merger of PRR and NYC. The net railway operating deficit of the New Haven in 1968 was $24.2 million.

The final word on the NH price came from the Supreme Court on June 29, 1970, eight days after PC had filed its § 77 petition for reorganization.[60] The ICC had set a price of $140.6 million which the reorganization court increased by $28. 9 million. The Supreme Court affirmed, expressly leaving open the question whether the financial obligations discussed in its opinion were subject to modification in or because of the PC § 77 proceedings.[61]

PROTECTION OF OTHER RAILROADS

In the Penn Central proceedings, the ICC imposed numerous conditions to protect competitive railroads. These included the standard DT&I routing and traffic conditions which limit the merged company's ability to discriminate against connecting lines with respect to routes, gateways, schedules and the movement of traffic.[62] It approved and prescribed, as a condition, the terms of an agreement between PRR, P&LE and WM relating to routes, rates and service between the Eastern seaboard and the Midwest through the Pittsburgh gateway.[63] The Commission also required PC to accept an agreement between NYC, NYS&W, and Seatrain Lines, a water common carrier, relating to certain rail-water routes.[64]

Unique protective conditions, never before used, were prescribed for the protection of EL, D&H and B&M pending decision on their petitions for inclusion in Penn Central or the N&W system. These provisions, commonly called the Appendix G conditions, were designed to maintain the status quo of traffic patterns of PRR, NYC and the three protected roads and to set up bases on which PC would indemnify the protected carriers against certain revenue losses after the PC merger and pending their inclusion in PC or in the N&W system where they preferred to be. The Appendix G conditions were extensively litigated. They evinced the Commission's concern for protection of the smaller lines and were reviewed in the Supreme Court's two opinions in the Penn Central Merger case.

LABOR PROTECTIVE PROVISIONS

The Interstate Commerce Act makes specific provision for the protection of employees involved in railroad unifications. The opening part of this report summarizes §§ 5(2)(c) and (f) of the Act relating to labor protection. The ICC recently argued that the "notwithstanding" last sentence of § 5(2)(f) [65] relieved it of any duty to review the adequacy of protective provisions contained in a collective bargaining agreement and that they were not accorded protection by an ICC order approving a unification, even though it gave its authorization "subject to such agreements." In the recent *Nemitz* case,[66] the Supreme Court

[58] Id. at 524–26; Pennsylvania R. Co.—Merger—New York Central R. Co., 331 I.C.C. 643, 699–721 (1967) (second supplemental report).
[59] Pennsylvania R. Co.—Merger—New York Central R. Co., 334 I.C.C. 25 (1968) (fourth supplemental report).
[60] New Haven Inclusion Cases, 339 U.S. 392 (1970).
[61] Id. at 398, footnote.
[62] Initial Penn Central decision, 327 I.C.C. at 541, 564–65, 835–42, 1041; Detroit, T. & I. R. Co., 275 I.C.C. 455 (1950).
[63] Initial Penn Central decision, 327 I.C.C. at 537, 563–64, 828–31, 938–39, 1041–42.
[64] Id. at 552, 831–32.
[65] The last sentence of § 5(2)(f) provides: "Notwithstanding any other provisions of this Act, an agreement pertaining to the protection of the interests of said employees may hereafter be entered into by any carrier or carriers by railroad and the duly authorized representative or representatives of its or their employees."
[66] Norfolk & Western Ry. Co. v. Nemitz, 82 S. Ct. 185 (1971).

rejected the argument. It found that the "notwithstanding" proviso provides the machinery for a premerger collective agreement and thus supplies the minimum measure of fairness required under § 5(2)(f).

Under ICA labor provisions, the Commission has prescribed several types of protective conditions. At the hearings, applicants proposed the imposition of modified *New Orleans* conditions.[67] In their initial brief filed June 1, 1964, they adhered to the modified *New Orleans* conditions, but referred to the agreement reached by PRR, NYC and various unions affiliated with the Rail Labor Executives Association on May 20, 1964. Applicants believed that the agreement did not require the Commission's approval. The Commission reopened the case for further hearing and on September 16, 1964, heard testimony concerning the labor protective contract.

By the time of the Commission's first decision of April 7, 1966, the merger partners were willing to make the terms of the 1964 labor contract available to all employees required to be protected including those not represented by unions signing the protective agreement.[68] By reason of the last sentence of § 5(2)(f), the Commission found that it could make no requirement for the protection of employees covered by that agreement. However, stating that the benefits of the protective conditions agreed to were greater than any theretofore required of any § 5 applicant, the Commission adopted the agreement as a condition of approval and required Penn Central to obtain assents to the conditions from employees not represented by the signatory unions.[69] The Commission later characterized the agreement as "providing for employee benefits far in excess of what had ever been required by this Commission and superior to benefits available in industry generally." [70]

Opinions differ about the wisdom of the May 20, 1964 agreement and its attrition provisions.[71] Uniform application of its provisions to all employees, improved employee morale and flexibility in work assignment are said to be valuable advantages of the agreement. Furthermore, applicants estimated the cost of protection under the agreement to be $78.2 million, all payable within eight years after merger, as against a total cost of $83.0 million under the modified *New Orleans* conditions.

RELATIONSHIP TO OTHER RAILROADS

In Subsections (1) and (3) above, the Commission's treatment of the inclusion and protection of other railroads was reviewed. A related protective condition provided for application by D&H for trackage rights over Penn Central between Hagerstown, Md. and Wilkes Barre, Pa. These rights would give D&H a direct connection to the N&W system and make possible competitive service to and from the South.[72]

Throughout the Eastern merger cases, the ICC followed the case-by-case method of decision. Occasionally, it came upon a troublesome matter growing out of this approach. The Lehigh Valley Railroad operates between the New York City area and the Buffalo gateway through Scranton, Pa. It was controlled by PRR through stock ownership and depended on PRR support for traffic. The examiners recognized and discussed LV's difficult position,[73] and the initial ICC decision provided for negotiations leading to LV's inclusion in either the C&O–B&O or the N&W system.[74] During the merger hearings, Penn Central expressed willingness to sell its interest in LV to C&O–B&O, but C&O showed no inclination to discuss the matter. The Commission in its initial decision directed Penn Central to retain its interest in LV and to render such support to LV as the Commission might determine; and if LV were not included in C&O–B&O or N&W, the Commission might direct its inclusion in PC if found to be in the public interest. LV's fortunes depended on Penn Central. Accordingly, it is presently in reorganization under § 77 of the Bankruptcy Act.

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[67] New Orleans Passenger Terminal Case, 282 I.C.C. 271 (1952).
[68] Initial Penn Central decision, 327 I.C.C. at 543.
[69] Id. at 544–45.
[70] Penn Central Merger case on reconsideration, 328 I.C.C. at 313.
[71] Initial Penn Central decision, 327 I.C.C. at 544–45, 686–87.
[72] Id. at 527, 924–25, on reconsideration, 328 I.C.C. at 322–23.
[73] Id. at 327 I.C.C. at 940–42.
[74] Id. at 544–55.

Finally, as to ICC approval conditions, the PRR's strategic position in the Eastern railroad structure was recognized. To fill out the divestiture program, the Commission required that, except as provided in the *N&W Merger* case, PC dispose of any interest it may have in any railroad corporation in the C&O–B&O and N&W systems and prohibited the acquisition of any such interest in the future.[75]

OTHER CONDITIONS

Several conditions of approval prescribed by the Commission related to the protection of rail service at specific cities. PC is required to enter into reciprocal switching arrangements at Pittsburgh with any rail carrier desiring such an arrangement.[76] The merged company is also prohibited from adjusting schedules or service or otherwise prejudicing the Port of Erie, Pa.[77]

Finally, several corporate and reporting matters were treated. The Commission directed PC to simplify its complex intercorporate structure and to submit plans relating to the motor carrier operations of certain subsidiaries.[78]

Merger Meant Consolidation

On the whole the Pennsylvania Railroad was larger than the New York Central. In 1963 when evidence was supplied for the hearings of the Interstate Commerce Commission, the Pennsylvania Railroad had 62,905 employees while the New York Central had 48,527; its railway operating revenue was $840,111,654 and assets were $2.3 billion to the New York Central's figures of $623,332,762 and $1.8 billion. But in other measures of size the two railroads were equal. The Pennsylvania Railroad had 9,706 miles of track while the New York Central had 9,927. From considerations of size the merger would be one between more or less equal partners. The two railroads were of sufficiently comparable size that one would not clearly dominate the other.

The geographical territory now served by the Penn Central is roughly the Northeast quarter of the United States. The bulk of its operations are bounded on the south by a line running from St. Louis to Baltimore and on the west by a line running from St. Louis to Chicago. The Great Lakes form its northern boundary from Chicago to Buffalo; a line from Buffalo to Boston (broken by a principal route north to Montreal) completes its northern boundary. About half of the Nation's population lives in the territory and 55 percent of its manufacturing plants are located there.

The territory served today by the Penn Central was largely the same territory served by both the New York Central and the Pennsylvania Railroad prior to the merger. To be sure, the Pennsylvania Railroad had eastern Pennsylvania, New Jersey, Delaware and Maryland free from the competition of New York Central lines. The New York Central was similarly free of the Pennsylvania Railroad in Massachusetts, eastern and upstate New York. Both railroads served the major cities of New York, Chicago, Detroit (although the Pennsylvania's representation there was small), Cleveland, St. Louis, Indianapolis, Cincinnati, and Buffalo.

West of the Alleghenies the routes of the two roads largely paralleled or duplicated each other. Both had a tangled network covering Indiana and Ohio. However, there was an important difference in their main lines for east-west traffic. The New York Central funneled its traffic along the water-level route from Albany to Cleveland. From Cleveland main lines ran southwest to St. Louis and northwest to Chicago. Another important line connected Detroit with Columbus. The water-level route offered the advantage of gentle grade and curves.

The Pennsylvania was forced to go over the more severe grades and curves through the Alleghenies on its principal route from Pittsburgh to Philadelphia. The rest of its principal route ran from Philadelphia north to New York and South to Washington, D.C. At the other end, major lines ran from Pittsburgh west to Chicago and southwest to St. Louis.

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[75] Id. at 553–54.
[76] Id. at 547, 554, 939.
[77] Id. at 547, 555, 945.
[78] Id. at 551.

The traffic carried by the two roads was similar. In 1963, 89 percent of the total tonnage of each road was composed of the products of mines and manufactures and miscellaneous commodities. Products of mines produced 29 percent of the Pennsylvania's revenues and 27 percent of the New York Central's; manufactures and miscellaneous commodities produced 55 percent for each. Agriculture ranked third for both roads. These patterns had remained constant during the preceding decade. Although there were differences in patterns within the general groupings, the two railroads relied largely on the same type of traffic. Thus, their operations faced similar demands.

The identity of geographic territory, parallel route structure and similarity of size and traffic patterns meant that the benefits of merger had to come from consolidation of duplicating operations. The New York Central and Pennsylvania Railroads brought roughly the same things to the merger. Neither could offer the other any particular advantages in terms of complementary seasonal peaks in traffic, new territory, or complementary route structure. The singular benefit of the merger was the opportunity to consolidate much of their east-west traffic over New York Central's water-level route. Although slightly longer in some cases then the Pennsylvania's route, it permitted bypassing the Alleghenies' mountainous grades and curves. Principally, the merger would permit elimination of duplicating operations and facilities and would allow consolidation of traffic into higher density patterns that could be handled more efficiently by the railroad.

What Consolidation Involved

Geography, size and traffic combined to require that the New York Central-Pennsylvania Railroad merger be a consolidation of facilities and operations and this was, in fact, the ground upon which the merger was justified and merger savings predicated. To understand the effect on the merged companies of their manifold differences in character—history, point of view, procedures and policy—one must examine what was involved in bringing about a consolidation.

First, as a matter of terminology, let us use "merger" to indicate legal and financial aspects of the combination of the railroads and "consolidation" to indicate the organizational aspects. Thus, the merger was made when corporate officials signed the necessary papers on February 1, 1968. Consolidation, on the other hand, involved reorganization of employees into new work patterns; it also involved a change in the physical flow of traffic over the rails. Consolidation required people to perform their functions differently or to perform new functions differently or to perform new functions. Merger need not require such changes. For example, the C&O and B&O merged, but they did not consolidate to any great extent; by and large, they were operated as before the merger.

Not so with the Penn Central. It was contemplated to be a complete consolidation of the two predecessor companies. Main line traffic was to be rerouted in order to achieve a pattern of maximum concentration of freight for the greatest distances over the New York Central's routes. Traffic over the lines of the former Pennsylvania Railroad was to substantially decrease. The degree of consolidation is indicated by the magnitude of traffic rerouting—it was estimated during the merger hearings that train-miles over the Pennsylvania's routes would decrease by one-third.[78a]

This amount of traffic rerouting required substantial addition to the capacity of certain terminal facilities; in fact, the hearing examiners believed that construction of a yard at Selkirk was "the single most significant change in terminal operations" and "the key to the merger program." [78b] Inevitably, a substantial relocation of employees would be required to handle the new traffic patterns. Saunders was proud of the labor agreement he had negotiated, because, while it might have been expensive in terms of employee protection, it permitted the railroad to relocate employees.

In the actual process of consolidation the Penn Central attempted where possible to mingle former New York Central and Pennsylvania Railroad

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[78a] Interstate Commerce Commission, Finance Docket No. 21989, Penn Central Merger, Hearing Examiners' Report p. 118 (1965).
[78b] Id. at p. 122.

employees. They were placed side-by-side and frequently superior-subordinate relationships were arranged so that an employee of one railroad reported to someone from the other railroad. Officers were similarly mixed in the executive suites, although there was some complaint that the Pennsylvania Railroad people got most of the higher positions.

To bring about the complete consolidation envisioned by the Penn Central a number of tasks had to be accomplished. Physical facilities had to be constructed to handle the rerouted traffic. A single set of operating procedures had to be devised and then taught to employees. Paperwork procedures for car control—routings and destinations—and for billing customers had to be adopted and put into consistent use throughout the system. Uniform computer and accounting systems had to be chosen and existing systems accordingly altered. Equally as important, a new organizational structure had to be developed so that superior-subordinate relationships could be developed and stable chain of command established. Decision-making authority had to be settled on appropriate officers.

It appears evident, at least upon hindsight, that consolidation was a complicated process that would require much time and effort to achieve. The New York Central and Pennsylvania pointed toward a "Merger-day" on which the merger could be finally consummated as if the new Penn Central could at once begin to operate according to its ultimate design. Little thought was apparently given to the difficult process of forging one company from the pieces of its predecessors.

Although it was acknowledged prior to merger that the full amount of merger savings would not be available for eight years, the basis for this delay was usually attributed to the costs of plant construction and labor protection. Costs resulting from the process of consolidation were not expected.

Preparation and Execution of the Merger

This section describes, in broad outline, how PRR and NYC prepared for the unification of their properties, managements and operations upon merger and how the merged company executed the plans.

The premerger planning was prepared in two main stages. At the time of the first negotiations in the late 1950's, the companies jointly and separately reviewed their operations and were in the course of completing a basic plan of merger. Upon resumption of negotiations in late 1961, this work was refined into the proposed routing and operational plan presented to the ICC and described at length in its initial April 6, 1966 report.[79] That plan covered the rerouting of traffic with detailed routes from and to major points and areas, changes in terminal operations, passenger terminal operations, and the coordination and elimination of maintenance facilities.

This planning, devoted primarily to definition of plant design, did not spell out the steps or processes necessary to move from two separate roads to one unified railroad.

After determining traffic routing, the capacity of track and terminals necessary to handle the expected traffic was determined. This was the only kind of information relating to implementation of the merger that was presented to the Interstate Commerce Commission in its hearings. The Commission did not question the railroads further about their plans, apparently assuming this to be an area for managerial discretion and that the company's interest in survival and profit would insure appropriate execution.

For example, a question was raised by the State of Pennsylvania about the location of the corporate headquarters. The hearing examiners dismissed the State's request that the Penn Central headquarters be located in Philadelphia with the observation that the interests of New York and Philadelphia in obtaining the headquarters balanced each other and that this was a matter for the company to decide. At another point the examiners noted a proposal to reduce the number of operating regions from 14 to 10 but concluded without discussion that the board of the new corporation would make the final decision on the matter.

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[79] Initial Penn Central decision, 327 I.C.C. at 654–73, 1018–24.

Committees composed of representatives of the two railroads continued to meet throughout the legal proceedings on the merger to plan for the eventual merger. It appears that the substantive contribution of such committees was to identify important areas of decision, describe the approaches of the two railroads to the issues, and propose approaches for the new railroad. Decisions were made only where there was a consensus on the recommendation. If a consensus could not be developed, decision was deferred.

After the presentation of evidence to the Commission, additional studies were made and resulted first in the Interim Plan and finally in the detailed Master Operating Plan. The Master Plan is said to have been completed after many months of effort on the part of the best informed people of both roads.[80] The companies used a somewhat formalized planning organization guided by a system coordinator for each railroad and staffed by 36 representatives of 18 departments. Aided by the repeated postponements of Merger Day, the organization refined the Master Plan and had it in form for distribution to the regional managers of the merged company.

Apparently at all stages, outside management consultants were extensively used to provide overall guidance and to prepare the organization and procedures of the merged company. One consultant was said to have had broad experience gained from work in mergers in a wide range of industries and situations.

In its initial decision, the ICC ruled on a petition for reopening the proceeding on the ground of newly discovered evidence, specifically, a December 1965 speech by PRR Chairman Saunders which referred to operating plans said to be different from those about which testimony was given at the hearings. Denying the petition, the Commission indicated that it, like the examiners, did not expect the merger plan to be carried out in all its details as proposed at the hearings.[81]

In addition to developing the Master Operating Plan, the planning organization facilitated communication between the departments of the two companies. No formal record is readily available of the extent to which the departments had reached agreements or resolved differences relating to their postmerger organization, policies and procedures.[82]

Differences, however, were explicitly acute in at least two areas of major importance. The two companies did not follow similar systems of budgeting and cost control, and their approaches to marketing were known to spring from different philosophies. And while numerous steps were taken to unify operations or functions and to carry out capital projects related to the unified service, the divergent fiscal policies were not rationalized, and the sales and marketing departments continued their intense competitive rivalry and different methods to the day of merger.

Perhaps most important to understanding the inefficiency of pre-merger planning is that no decision-making authority was created until the merger was consummated. There were two more-or-less equal companies involved in the planning until the merger papers were signed. Neither could be forced to accept something it did not want. There was no strong man or group dominating both companies who could make consistent decisions for both railroads prior to the merger. What could not be mutually agreed upon had to await resolution by the board of the new company.

It is not clear that much attention was given by top officers to the steps necessary to make the merger work. Saunders apparently devoted his efforts to the legal, political and publications matters required to secure approval for the merger. He left matters of operations to his subordinate officers. Perlman, on the other hand, devoted his efforts to building up the strength of New York Central as an individual railroad.

To the top officers, the most important issue was probably to keep strong differences between the railroads from reaching the public in order not to

[80] See memorandum from David E. Smucker to Stuart T. Saunders, November 13, 1969, Appendix D, Exhibit 65, p. 704.

[81] Initial Penn Central decision, 327 I.C.C. at 484-86.

[82] Only two departments in the two roads, the financial groups, did not participate significantly in the major planning through the principal merger coordinators (Cole and Kattan). The financial departments ultimately arrived at an accommodation: in the final organization chart, the financial work appears under two separate lines of management, financing under David C. Bevan (PRR) reporting to Chairman Saunders and accounting under Walter R. Grant (NYC) reporting to President Perlman.

disturb public opinion and jeopardize final approval of the merger. Thus, they could be expected to avoid discussion (and resolution) of divisive issues.

No evidence has been found that PRR and NYC considered in depth a corporate merger on merger day and a physical consolidation of facilities and personnel at a later time. PRR executives appeared to have a sense of urgency about the necessity for integrating operations as promptly as possible after authorization, but NYC counterparts often centered on long-range studies. In any case, the Master Operating Plan was developed, refined and appeared to be ready on Merger Day for immediate and comprehensive use.

A short time before Merger Day, the two chief executive officers, Saunders and Perlman, met and selected personnel from the companies for the upper levels of Penn Central management. As agreed by the two partners, Saunders would be PC's chairman and chief executive officer, and Perlman its president and chief administrative officer, upon merger. Of the departments selected to report to the president, three of major importance (operations, sales/marketing and personnel) were headed by former PRR men, and three NYC executives were in charge of accounting, industrial development/real estate, and purchases/materials. Four NYC men also reported to the president for departments handling various research, systems development and management planning functions and miscellaneous services. Directly under Chairman Saunders were the finance department, the secretary's office, the legal department, and public relations, all headed by former PRR personnel. In the second and third level staff positions were persons from both companies, about equal in number overall, but not evenly distributed among departments. For example, in the operating department, under the executive vice president reporting to the president were seven former NYC and three former PRR officers.

What Was Left Undone on Merger Day

On January 15, 1968, a decision came down from the Supreme Court clearing the way for the New York Central to merge with the Pennsylvania Railroad. At that point consolidation could begin in earnest. The fundamental decision about traffic routing had been made; the key terminals, yard and connection work had been identified. It now remained to implement those plans. This was no small task as the record of activity for the following two years indicates: 10 classification yards were built or enlarged; 35 key terminals were consolidated (a total of 51 freight stations and terminals consolidated in 1968 and 54 in 1969); four yards were eliminated in 1968 and two in 1969; and numerous rail connections made.

The Penn Central's own records show that it made a cash outlay of $90.2 million for capital improvements, $64.6 million for labor protection, $18.6 million for the purchase of homes, training and excess overtime, $15.0 million in excess per diem and $16.7 million in lost income (due to diversion of $33.4 million in revenue traffic).[83a] Totaling $205.1 million, this sum provides a monetary measurement of the magnitude of the consolidation process in the first 23 months of Penn Central's short life.[84b]

The Penn Central recorded merger savings of $73.9 million, $9.6 million of which were related to incorporation of the New Haven. Thus, consolidation of the New York Central and the Pennsylvania Railroad produced a net savings of $64.3 million so that the first 23 months of operation required a net cash outlay of $140.8 million.

Decision To Rush Consolidation

In a memo on November 8, 1967 to Saunders, Financial Officer David C. Bevan discussed the Pennsylvania Railroad's desperately declining cash position (expected to go to zero within 2 months) and stated the inescapable need to sell about $72 million in debt securities. To do this, the Pennsylvania would be

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[83a] Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation, Brief of Bureau of Enforcement, p. 84 (March 8, 1972).

[84b] Other expenses were incurred by reason of inclusion of the New Haven in the Penn Central system but do not reflect changes in plant and organization stemming from the planned consolidation.

forced to obtain agreement from the New York Central to raise the debt limits set in the merger agreement.[85]

Thus, when the final decision came down from the Supreme Court on January 15, 1968 permitting the merger, the Pennsylvania Railroad rushed ahead, its enthusiasm spurred by knowledge that it would run out of cash if left on its own. Although the situation at the New York Central is not set out as explicitly in the records, it was doubtless only slightly less anxious. The New York Central was also very short of cash.

The New York Central and the Pennsylvania Railroad found themselves no stronger in union than in independence. Immediate action had to be taken to keep the Penn Central afloat. Since top management believed the decade of rhetoric that vast savings would occur upon the consolidation of the two railroads, a crash program was undertaken to achieve those savings as soon as possible. The course was to consolidate the two railroads at once.

Several months after bankruptcy, Perlman testified to the Senate Commerce Committee with obvious pride that physical work originally scheduled for completion in five years has been done in two years.[86] Apparently, most of the merger start-up capital costs were expended in 1968 and 1969 rather than prorated over the longer period. Perlman regarded this as a tremendous achievement.

The computer systems of the two roads had to be consolidated after consummation of the merger. The better system was not necessarily chosen because speed was very clearly the primary criterion for the process.[87]

Not only in the computer area, but throughout the entire railroad it appears that speed was the primary criterion and the overriding goal in the consolidation process.

Although savings were produced by the consolidation, speed had its costs. In the hearings Senator Hartke inquired of Perlman:

> After the merger occurred, did the expectations which you had anticipated in regard to increased efficiency and better service, did they occur?
>
> Mr. Perlman. No, sir, not the first 2 years and I didn't expect them to occur then.
>
> When we rebuilt the yard, say at Albany before merger, put in the new electronic yard, we had to throw everything over to the Syracuse yard. Just that one thing disrupted the New York Central service for 6 months.
>
> Now you take changing service at 35 yards within 1 year and you have got a heck of a mess.[88]

Mr. Perlman's testimony revealed clearly his belief that service deterioration was a necessary by-product of the consolidation process and that the faster the consolidation could be accomplished, the faster service could be restored to acceptable levels. He noted, in fact, that shippers were very happy with the service by the following spring (1969).[89] He did not indicate that any consideration had been given to strategies designed to minimize service deterioration during consolidation.

He was concerned only that it was done quickly. Whether his concern arose from the financial weakness of the railroad or from a personal belief that sharp pain quickly over is preferable to a prolonged dull ache is not known. In either case, the direction given to consolidation of the Penn Central would be the same.

PRR and NYC formally merged on February 1, 1968. Whatever the extent, merits or depths of the planning for merger, whatever the bright prospects of great economies envisioned by combining the two carriers operating many miles of parallel railroad and serving many common points, Penn Central's management found it impossible to merge the properties, provide reasonably good

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[85] Memo from Bevan to Saunders, November 8, 1967. Appendix D, Exhibit 36, p. 558.

[86] Hearings before Senate Committee on Commerce, *Failing Railroads*, 91st Congress, 2d Session, Serial No. 91–90, Part 2 at 393.

[87] Cf., Interstate Commerce Commission, Docket No. 35291. Penn Central Investigation, Verified Statement 32, p. 4.

[88] Hearings before Senate Commerce Committee, cited supra, note 82[d] at 391–2.

[89] Id. at 393.

service and maintain a solvent operation. In broad and brief outline, the sad course of events went as follows:

Upon merger, Penn Central expedited its plans in some respects and postponed them in others. The objective appeared to be the achievement of economies as rapidly as possible. In labor relations, by November 1968, PC had implemented the 1964 basic protective contract by making agreements with unions representing 86 percent of its union employees. Accordingly it proceeded with the relocation of personnel, made consolidations of facilities with reduction of the work force, and terminated employment under the interim pensions and separation allowances provided by the labor contract. The actual cost of the labor protective agreement greatly exceeded estimates. One must conclude that management must have decided to follow a greatly accelerated program to achieve economies, badly estimated the cost, or misused the contract arrangements by improvident transfers and separations.

Merger of the PRR–NYC physical operations utterly failed. The service became so unacceptable to shippers and connecting lines that much traffic was lost or was routed around PC over competitive railroads. The causes of the operational collapse were many, some of them controversial. One general hypothesis summarizing them reflects the seemingly insuperable difficulties attending the abortive attempt to unify the operations. But first this comment: discussing the claim that the combined properties would result in an unwieldy company difficult to manage efficiently, Chairman Symes in his merger testimony pointed out that the merged company would not be as large in many respects as PRR alone at various times in the past and, in some instances, not as large as NYC alone. The measures cited include number of employees, equipment owned, locomotive units owned, revenue passengers handled, revenue ton miles, and total train miles.

One hypothesis explaining the operational collapse can be simply stated. Despite extensive planning, incompatible partners not truly receptive to the merger were not ready either to merge or to carry out the plans; and because of inadequate execution, instant merger created and compounded operating problems and ultimately led to chaos.

After the bankruptcy and after the ensuing congressional and public uproar, the ICC instituted a formal investigation of the Penn Central collapse and directed its Bureau of Enforcement to participate in the proceeding. In its presentation, the Bureau reviewed and analyzed the postmerger operations of Penn Central.[90] It first pointed to the congestion at key terminals and yards in the immediate postmerger period. One cause of congestion was that ill-prepared clerical forces were unable to execute the classification and routing of the combined traffic in fulfillment of the basic operating plan or any other plan. Clerical error separated cars from their billing, and the no-bill cars intensified the congestion. Massive problems of communications appeared; the incompatibility of the PRR and NYC computerized systems for car location and movement information was not solved until June 1968, although the problem was recognized well in advance of the merger. Shortages of locomotive power seriously delayed train movements. The disrupted and disorganized operations aggravated an insufficient supply of boxcars, hoppers, gondolas and other freight cars. The handling of traffic interchanged with connecting lines, the Bureau asserted, was fraught with confusion, and the confusion obtained at both the eastern and western connections of Penn Central.

The Master Operating Plan prepared by the planning committee was ready for use on Merger Day. To what extent the partners were committed to its use is not now easily ascertained, but the plan must have had the approval of both parties. Each was equally represented on the committee, and each had at least the right of dissent. No record of dissent had been found other than the fact that immediately following merger the Master Operating Plan was marked "preliminary", was not used and was not resurrected until about October 1969.[91] To what extent this Plan was followed or tried is not definitely known.

[90] Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation, Brief of Bureau of Enforcement (March 8, 1972).

[91] See letter dated October 14, 1969, from R. G. Flannery, Vice President—Operations, to the regional managers concerning "Master Operating Plan Progress and Appraisal", Appendix D, Exhibit 68, p. 716.

The confusion generated by the operating difficulties was intensified by the virtual breakdown of procedures for the billing and collecting of freight charges. Millions of dollars due Penn Central were not seasonably collected. Cash, inadequate as it was on Merger Day, was further and rapidly depleted.

Quite clearly, the labor protective agreement (at least as implemented) and the inclusion of the New Haven proved improvident. They may indeed have been the price for securing approval of the merger, but the costs of labor protection and the New Haven inclusion were major factors in the financial collapse of the company.

In his testimony before the Senate Commerce Committee in July 1970, former Chairman Saunders of Penn Central enumerated some of the reasons why Penn Central was forced into reorganization under § 77 of the Bankruptcy Act ("the factors that really broke our back").[92] He referred to the inflation-caused spiralling cost of operating the railroad (the increase in 1969 being $100 million for Penn Central), the inadequacy of revenues because of recession and the time lag in getting freight rate increases, the huge deficit from passenger operations, the heavy merger startup costs amounting to $193 million after taking into account $74 million in merger savings, inadequate divisions of revenues with Southern and Western railroads on interterritorial traffic, and the inclusion of the New Haven in the merged Penn Central. These problems, he said, presented conditions which were "unmanageable" and made it impossible to operate the railroad on a break even basis. He said that the net merger startup costs were substantially larger than were presented in the initial ICC merger decision.[93]

However viewed, the leakage of cash was of flood proportions, the operating losses were overwhelming, and the result was Penn Central's petition for reorganization filed June 21, 1970.[94]

Failure to Reorganize

The chaotic conditions that existed on the Penn Central during consolidation cannot be attributed solely to the disruption caused by construction projects or the physical changes in traffic routings. The continuing unorganized condition of the company is fundamental to understanding the company's descent into reorganization. The rush to consolidate, in effect, resulted in the destruction of the organizations, to greater or lesser degree, of the predecessor companies. The Penn Central was not able by the time of its bankruptcy to create a new, cohesive and coordinated organization to take their places. The disruption caused by physical changes in the plant was compounded by the continuing failure to put the pieces of the merger back together again. A key element in every organization is a structure of management personnel that is able to provide effective leadership. This must be doubly important when the disruptions of massive changes are present. Yet, a stable management structure was not created at the Penn Central. A revealing account of the organizational deficiencies of the Penn Central is set out in the April 6, 1970, Interim Report of the President's Task Force, just two and a half months before bankruptcy.[95]

A measure of management instability is the very large turnover in management personnel at all levels cited by the Interim Report:

61% of Trainmasters in their present assignments less than one year.

81% of Transportation Superintendents in their present assignment less than one year.

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[92] Hearing before Senate Committee on Commerce, *Failing Railroads,* 91st Cong., 2d Sess., serial No. 91–90, Part 1, pp. 298–364 (1971).

[93] See letter dated May 15, 1972 from S. T. Saunders to the Secretary of the Interstate Commerce Commission in connection with Docket No. 35291, the ICC's Penn Central investigation. Appendix D, Exhibit 69, p. 717.

[94] See brief dated March 8, 1972 of the ICC's Bureau of Enforcement in the ICC's Penn Central investigation, Docket No. 35291, pp. 84–106, 116.

[95] Mr. Gorman, who became president in December 1969, appointed the Task Force to evaluate the activities of operating regions. See Appendix D, Exhibit 64, p. 702, for full text of "Interim Report—President's Task Force" dated April 6, 1970.

44% of Division Superintendents in their present assignment less than one year.

80% of Division Superintendents in their present assignment less than 15 months.

Changes in management personnel extended even into the executive suites. By the end of 1969 Mr. Perlman was no longer president. And the Executive Vice President for Accounting, Mr. Grant, the Executive Vice President for Operations, Mr. Smucker, the Senior Vice President for Labor and Personnel Relations, Mr. Knight, the Vice President for Transportation, Mr. Kennefic, and the Vice President—Corporate, Mr. Gerstnecker, to name a few principal officers, had left the Penn Central.

The preface to the Task Force's July 22, 1970, report on the Central region notes:

> The Task Force, in the reports of April 6, 1970 and May 20, 1970, concluded that one of the major problems in achieving better results was a lack of stability and proficiency in front-line supervision brought about by the many changes resulting from merger.
>
> The Central Region has been much less affected by merger problems. The geographical territory is much the same as it was prior to February 1, 1968. Of even greater importance is the fact that the Central Region recognized (under the prevailing conditions of merging) the value and need to establish an adequate degree of stability in regional and divisional supervision. A large segment of this supervision has been in their present assignment for at least two years. As a result, there is an atmosphere of stability on the Central Region which was not apparent on the Western Region. This apparent difference between the two regions substantiates our belief that transfers of key personnel and other changes should be minimized during the next one to two years and training of front-line supervision to improve their proficiency should be emphasized.

The clear inference is that the degree of disorganization that existed up to the time of the Task Force interim report was not a necessary result of the merger. That there was less disorganization in some regions shows that management could have exercised control over the situation in other regions.

Other indications of disorganization spotlighted by the Interim Report are: lack of uniform procedures for payroll claim processing, car reporting, and management reports; lack of defined duties and responsibilities in some supervisory positions and lack of uniformity in activities in those positions between regions and divisions; lack of adherence to the operating plan; and lack of uniformity in promotion and training programs.

The Interim Report notes a lack of adherence to the operating plan. Whether there was indeed a uniform operating plan, at least in the early days of the consolidation, is questionable. In a memo to Saunders on November 13, 1969, Smucker pointed out that savings on merger projects have fallen short of estimated savings by 50 percent, complained that neither the Master Operating Plan nor the previous plan (placed in the record of the ICC merger hearings) had been followed, and called for a sweeping plan to be adopted and actually followed in the future.[96]

Since Smucker had been ousted from his position as Executive President for Operations nine months before, the credibility of his memo might be questioned. The press has recorded a bitter dispute between Smucker and Perlman and concluded that Perlman succeeded in dumping Smucker.[97] Saunders later claimed that he and Perlman agreed that Smucker had not done the job and that together they replaced him.[98]

However, even allowing for an element of self-vindication that may have motivated Smucker's memo, there are external factors that indicate the accuracy of the thrust of its allegations. The emphasis on speed and the disruptions that erupted during consolidation would make following any plan quite

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[96] See Appendix D, Exhibit 65, p. 704.
[97] Loving, *Fortune*, "The Penn Central Bankruptcy Express," August 1970.
[98] J. Daughen and P. Binzen, *The Wreck of the Penn Central*, p. 121 (1971).

difficult. In addition, Perlman was noted for his propensity to run a railroad from information in his head and intuition rather than from formal plans. His method of operation on the New York Central apparently was to spot problems to be corrected by traveling around the railroad in his business car. It is, therefore, not unlikely that he would have continued to devise ad hoc solutions to the manifold problems of the Penn Central.

The lack of defined responsibility for important supervisory positions and lack of uniformity between regions further indicate that changes or reorganization were not made systematically. The Interim Report states that people in divisional and regional supervisory jobs of data control and operating rules, supervisors of yard procedures, supervisors of train movement, and chief dispatchers, among others, were forced to rely on their past experience or differing individual ideas for definitions of their jobs. This is astounding in view of the vital importance of information and efficient train operation toward making a success of the Penn Central. The Interim Report recommends definition of duties and responsibilities for each supervisory position in the Transportation Department as "a necessary first step toward establishing transportation guidelines that will be uniform throughout the company." Two years after the consolidation began seems woefully late for such important first steps to be formulated.

Disorganization was by no means confined to the transportation department. Peat, Marwick, Mitchell & Co. were hired to perform an outside investigation of the freight billing system. Their December 22, 1969, report found excessive delays in billing, inadequate management control over the quality and promptness of billing, poorly trained and confused personnel and a threat to the integrity of financial control by the very organization of the operation.[99] Errors generated in the system continued throughout the entire cycle until brought to the railroad's attention by customers because there was no positive control system. Peat, Marwick suggested initiation of comprehensive training programs for freight billing personnel, expecially those who dealt with disputed rates. They recommended a change in organization to take agents out from under the control of trainmasters. Trainmasters were responsible for moving cars and trains while agents were responsible for the documentation of moves. Priority was naturally given to car movement by trainmasters and they used agents for operating duties when pressing agency problems deserved their undivided attention.

Because of poor management, the freight billing process of the Penn Central was slowed and money owed to it remained in the hands of its customers. Thus, poor management thwarted the prime purpose in speeding the consolidation which was to obtain funds to stave off collapse.

Corporate Character

The corporate characters of the merger partners also have some bearing on the collapse.

The Pennsylvania Railroad was part and parcel of the Philadelphia social establishment. Civic pride played a large part in the railroad's founding in 1846. It was established to insure a continued flow of commerce through Pennsylvania and Philadelphia and thereby to maintain their importance in the economy of the growing country. Philadelphia contributed $5 million of the first $12 million to the railroad's capital and received in return three seats on the board (which it held until 1879). The original identification of the Pennsylvania Railroad with Philadelphia continued throughout the railroad's history. The western, Main Line, suburbs of the city came into being because the railroad developed land adjacent to its right of way into residential use. The city's social structure was characterized by clubs and the extensive membership of the Pennsylvania's officers demonstrated the railroad management's substantial social standing.

On a broader scale, the railroad that was created by a state legislature came thereafter to work its influence on the legislature. Its earliest presidents num-

[99] Letter and report from Peat, Marwick, Mitchell & Co. to C. S. Hill, Dec. 22, 1969; see Appendix D, Exhibit 66, p. 705.

bered among their ranks skillful politicians and the railroad seemed to have little difficulty obtaining what it wanted from the State. Nor was its political orbit limited to the State. Its last president, Stuart T. Saunders, apparently had a close relationship with administrations of both parties in the national government.[100]

The Pennsylvania Railroad was secure in its place in the Social Register, long in tradition and proud of a reputation earned in the 1920's as the "standard railroad of the world." It was the largest railroad in the country, had survived the Depression intact and without bankruptcy, and remained a substantial force in the business community of the Nation. The railroad's character, if a corporation can be said to have one, must be likened to that of the paradigm person of social standing: genteel, guided by tradition, sensitive to the values and opinions of his peers. The Pennsylvania's peer group was an exclusive one. Because it was the leader of the rail industry in a sense (by virtue of its size and strategic location), it felt itself superior to other railroads. However, its railroad character could not be denied, so that it could not precisely be a member of the fraternity of large corporations.

It appears that the Pennsylvania Railroad responded substantially to the people its management met socially. Its direction was determined more by the social ethos of Philadelphia and its own traditions than by the demands of the market or the concepts of the business community at large.

In the decade preceding the merger the railroad's direction seemed largely determined by tradition. Although there were a number of strong and able men in its upper echelon, it is difficult to identify one voice that uniquely shaped the railroad's course of action. There seemed to be no strong leadership of the railroad either by an individual or by a single body of its corporate structure. The board of directors largely rubber-stamped decisions that the management brought to it. It neither dictated nor criticized corporate policy.

The management was not a single body unified by a chief executive officer. Rather it was divided into several, somewhat independent, spheres of influence each of which had a degree of access to the board, and which contended with one another to make general policy decisions. Within the separate domains, the dominant officer went his own way. The task of the chief executive officer was to mediate between other officers rather than to determine the railroad's course.

Lack of unified leadership meant that yesterday's decisions modified by an accretion of compromises controlled the railroad. This made for very diffuse corporate policy and prevented the formulation of effective over-all goals for the railroad. It was difficult to hold one person responsible for the railroad's performance because no one officer controlled it. It also made it difficult to adapt to changing circumstances because no one took a global point of view. Each officer responded to the circumstances of his narrower field of responsibility.

The decision to merge with the New York Central offers an example. The initial decision was apparently made in 1957 by Symes, who was then Chief Executive Officer. Once that decision had been made, it remained corporate policy, apparently never seriously questioned, during the years that the New York Central spurned the advance and it continued to be corporate policy throughout the remainder of the decade required to bring the merger about.[101] Passing over officers in the company, Symes brought Saunders in to succeed him in the railroad's top position. Saunders saw his principal duty to be accomplishment of the merger. He left the railroad's finances and operations largely to other officers. It does not appear that Saunders ever re-analyzed the principal of merger with the New York Central; that decision had been made and his job was to bring the merger into reality. [Neither does it appear that Saunders ever closely considered what would be necessary to make the merger work once it was legally possible. That, perhaps, was the duty of others.

The dominant character of the Penn Central management seems to have been one of compromise and reconciliation, born of the need to strike compro-

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[100] *See*, J. Daughen & P. Binzen, *The Wreck of the Penn Central*, Chap. 2 (1970), for an account of the railroad's past.

[101] See Hearings before the Senate Commerce Committee, *Failing Railroads*, 91st Congress, 2d Session, Serial No. 91-90, Part 1, p. 325 (1970): p. 325: "Senator Hartke. . . But that decision to merge—was that not a managerial decision?

"Mr. Saunders. I suppose it was. It was made before I came. I didn't initiate this merger."

mises between its independent top officers and of the need to reconcile new policies with the dogma of tradition, the feelings of fellow club members, and the views of the political leaders upon whom they depended.

In contrast to the Pennsylvania Railroad, the New York Central did not possess a secure connection to a community and to the past. Although it was the (second or third) largest railroad and without doubt an important fixture in the commerce of the Nation in the decade preceding the merger, it was a kind of lone wolf, cut off from its peers. Its historic association with the New York banks was disturbed by Robert Young's take-over in 1954. Young campaigned against bankers and the rail industry establishment in his fiercely contested proxy fight and installed a hand-picked board upon his victory. Dominance over the railroad passed to his Alleghany Corporation, found by the ICC to be in control of the railroad.

Along with his board, Young brought in Perlman to run the railroad. Perlman had been educated as an engineer at MIT and believed in the value of education above traditional railroad experience. He brought college graduates into responsible positions and encouraged innovation in railroad operating and marketing policies. He also believed in spending money on plant modernization in order to achieve operating savings. Volatile in temperament, he was a tough, blunt man who did not hesitate to state matters as they appeared to him. Accommodation and compromise were not his characteristic approach. His job at the New York Central was not to make friends but to make the railroad run profitably. He was also the only Jewish top executive in an industry not noted for its tolerance; this combined with his character kept him from an easy camaraderie with the industry.

Young committed suicide in 1958, shortly after he had opened merger talks with Symes. His Alleghany Corporation was shortly thereafter plunged into a vigorous battle among stockholders for control, diverting its attention from the affairs of the railroad. Thus, Perlman became the controlling voice at the New York Central. The railroad was organized so that his officers reported information and problems to him and the railroad's decisions were in his hands. There was no division of powers, no independent domains, as there were at the Pennsylvania Railroad. Neither was there a lack of corporate goals or direction; Perlman had a vision of what the railroad should be. He molded the New York Central into his own image to the extent that he could—an aggressive, non-traditional railroad oriented toward new styles in management control and marketing policy, intensely focused on making railroad operations efficient and profitable. By the middle of the 1960's the New York Central was characterized in the press as the most progressive railroad in the East.

Yet, similar to Saunders at the Pennsylvania Railroad, Perlman lacked complete control over the railroad's future. Although Perlman dealt with financiers as president of the Railroad, he was not a financial man and could not bend them to his will. Perlman did not want to merge with the Pennsylvania Railroad, yet was forced to do so because he could not put together an alternative merger with the B&O nor could he block the C&O's take-over of the B&O. Neither had he been able to cure the fundamental weakness of the New York Central. Believing that the New York Central could not stand by itself against the competition of other large Eastern railroads in the process of merger, Perlman capitulated to the Pennsylvania's merger offer.

Differences in organization reflected the different policies of the railroads. The Pennsylvania Railroad saw its basic role to be the movement of large volumes of traffic. Securing and keeping traffic were fundamental to this approach. Thus, the Pennsylvania Railroad had a vice president of traffic who reported to the president. Subordinate to him were assistant vice presidents of marketing and traffic. The sales function was located within the traffic area. Market research and pricing were located within the marketing area. Within the marketing area, market research played a supporting role for pricing, being used to justify prices rather than to determine them. Prices were determined on the basis of tradition and negotiation with major customers. The end result was that sales had a stronger voice in the organization than did market research.

At the New York Central the situation was reversed. Vice presidents for sales and marketing each reported directly to the executive vice president,

thereby establishing a greater degree of visibility and responsibility for marketing. The New York Central gave a dominant role to market research. On the basis of research findings and conclusions, the New York Central would develop new services and price them accordingly.

Another significant difference in organization was in the crucial area of introduction of computers into the railroads' operations and paperwork. The Pennsylvania attempted to computerize its operations on a system-wide basis all at once. The New York Central, on the other hand, moved gradually, first introducing computers in one area of operations, then another. Computerization was treated as a service for existing functions so that its costs were billed to the other functions of the railroad and the computer people had to convince those who paid the bill of the worth of their service.

Another important difference was in the accounting function. The Pennsylvania Railroad had adopted responsibility accounting where officers were responsible for meeting the budget and profit requirements for functions within their control. Officers formulated a budget for their functions and submitted them for review at a higher level where they were incorporated into a broader budget. The budget became the chief means of expressing corporate goals and also of monitoring performance.

At the New York Central, budgets were formulated in headquarters and imposed upon the organization. Budgets were not used as a control mechanism but rather as a way of allocating resources. Historical reports of financial and operating performance were utilized to control the railroad's operation. The chief function of accounting at the New York Central was to provide data on costs and revenues so that the profitability of its different services could be determined. The responsibility accounting approach had been suggested to the New York Central but had been rejected.

The Pennsylvania Railroad might be viewed as having a more decentralized organization than the New York Central. Decisions were made at lower levels and reviewed by superiors as, for example, in the budget process. More importantly, decisions were made in the independent domains of finance, operations, and traffic which had been carved out by the several officers on the railroad. The chief executive officer seemed basically to coordinate the decisions of others. The New York Central, on the other hand, seemed organized to pass information upward so that decisions could be made at higher levels.

These differences between the New York Central and Pennsylvania Railroad, while evident and strong, do not by themselves indicate an incompatibility so fundamental as to foredoom the merger to failure. They do indicate that substantial adjustments would be needed in the merger whatever its guiding organizational principles.

Overview and Conclusions

In this section, the Penn Central merger is related to the rail system in the East; Government participation in the proceedings and overview is summarized; and the effect of the merger on the collapse of Penn Central in June, 1970 is examined.

The basic law governing rail unifications has not changed since the Transportation Act, 1940, made ICA §§5(2) to (13), inclusive, applicable to all carriers regulated by the ICC. The law made it possible for PRR to have the power to veto, if not to control, the ultimate revision of the structure of railroads in the East. Since prior to 1920 when unification provisions were first added to the ICA, PRR had a substantial stock interest in N&W. N&W served the lucrative Pocahontas coal fields. Evidently the ICC considered the PRR–N&W affiliation not harmful, for no move was made to disturb it until approval of the N&W–NKP–Wabash system on June 24, 1964. The Commission made that approval subject to PRR's divestiture of its interests in both N&W and Wabash. PRR consented to the divestiture. By that time, the C&O's control of B&O authorized in December 1962 had been consummated, and the system was in operation.

In the *N&W Merger* case, the ICC disavowed that it was restructuring the East. Nonetheless, one fact is clear: With the Commission's approval, by the end of 1964, two new systems, N&W and C&O–B&O, were formed

around the cores of two strong railroads and were well underway over three years in advance of the consummation of the Penn Central merger. They both had direct access to the important industrial areas of the East and ocean ports as well as to the Pocahontas coal fields. Penn Central had somewhat broader territorial coverage and in many respects equalled C&O–B&O and the new N&W combined. The 1965 proposal to form an N&W/C&O–B&O system was based in large part on the alleged necessity of meeting the coverage and competitive strength of PRR and NYC unified as Penn Central.

The ICC was early committed to a case-by-case method of deciding the unification proposals, and repeated efforts to change that approach failed. The basic applications for approval of the three new systems were filed in a period of less than two years (June 1960–March 1962), and at the time of the Penn Central hearings in 1963, all were still pending before the ICC. The ICC's decisional method may have simplified administrative handling, but prevented overall consideration in public of the merits of the several unification plans in the context of national and regional goals and needs.

Would consolidation of the cases have yielded different results? Given the ICC's passive attitude it is difficult to say. The ICC is empowered to condition but not compel a unification of carriers.[102] Any railroad not satisfied with conditional approval can refuse to proceed with a proposed unification. C&O's refusal to join in a C&O–B&O–NYC system is said to have forced NYC out of the *C&O–B&O* case and into the proposal to merge with PRR. The dangers to NYC were recognized and were briefly treated in one paragraph of the ICC's 1962 decision approving the C&O–B&O affiliation. The Commission realized that the Central was "not well able to absorb any substantial loss of traffic", but concluded that the prospective loss of revenues to NYC was not such as to require disapproval.[103]

The C&O–B&O affiliation consummated in February 1963 is often regarded as the keystone of the present alignment of Eastern railroads. At that time, apart from statutory standards set out in the Interstate Commerce Act and the antitrust laws, Government policy relating to mergers in the railroad and airline industries was being developed. President Kennedy, in his April 5, 1962, message to Congress, directed the Departments of Commerce, Justice, and Labor and the Council of Economic Advisers to form an interagency committee to develop criteria to determine whether proposed mergers are in the public interest.[104] The message stated three general guidelines. The first provided that effective competition should be maintained among alternative forms of transportation and, where traffic volume permits, between competing forms in the same mode of transportation. The second criteria aimed to secure economic, efficient and adequate service to the public "by the realization of *genuine* economies." Under the third criteria, affected workers should be given assistance to make necessary adjustments caused by a merger. The Interagency Committee on Transport Mergers issued its report stating the general criteria in January 1963 after ICC approval of C&O–B&O control the preceding month and a few days before consummation of that control.

On October 1, 1963, the Interagency Committee made a public statement opposing the Penn Central merger. That merger, it claimed, would eliminate a vast amount of beneficial rail competition. The committee referred to the dominance of the merged company in the East and saw danger to several smaller railroads not included in the merger. The merger, it said, would preclude a more balanced restructuring of the East.

The Department of Justice had intervened in both the *C&O–B&O* and *N&W Merger* cases. In the first, it did not oppose approval, but urged consolidation of the two cases with the PRR–NYC proceedings.[105] In the second, it made a similar contention, but also pressed for inclusion of Erie-Lackawanna in the transaction, and stipulated into the record a memorandum developing the ties between N&W and PRR since about 1900. On brief before the examiner, it asserted that, by reaching agreements with various intervening railroads, N&W succeeded in silencing all carrier opposition to the proposed merger, that

[102] Cf. St. Joe Paper Co. v. Atlantic Coast Line Ry. Co., 347 U.S. 298, 315–21 (1954).
[103] Chesapeake & O. Ry. Co.—Control—Baltimore & O. Ry. Co., 317 ICC 261, 282 (1962).
[104] Message from the President Relative to the Transportation System, H.R. Doc. 384, 87th Cong., 2d sess., 8 (1962.)
[105] C&O–B&O case, 317 ICC 264. (1962).

as a result, the record was inadequate to enable the determination of the public interest issue, and that the applications therefore should be denied. At the oral argument, it maintained that the proposals should be approved only if PRR's financial interests in N&W were eliminated and Erie-Lackawanna included in the transactions.[106] The Commission found the record adequate, approved the N&W merger without requiring inclusion of EL at that time, and ordered PRR's divestiture of its interest in N&W and Wabash as a condition of approval.

Commissioner Tucker dissented in both the *C&O–B&O* and *N&W Merger* cases. In *C&O–B&O* in December, 1962, in his lengthy dissent, he commented that the public bodies are not in a position to present public, as distinguished from private, evidence. He picturesquely described the failure of large Eastern railroads to present opposing evidence to be the "natural consequence of their own self interest which dictates a reciprocity of silence."[107] In the *N&W Merger* case in June, 1964, he considered that for such a unification proposal to be submitted on a relatively "noncontroversial" record dealing with the entire region, the proceeding was deficient in some respect. On the other hand, with some foreboding, he noted the rather formidable opposition to the PRR–NYC merger, not the least of which was the President's Interagency Committee on Transport Mergers.[108]

The Interagency Committee opposition disturbed PRR and NYC and evidently intensified their efforts to neutralize the protests against the merger. After realization of C&O–B&O control in February 1963 and the new N&W system in October, 1964 and with the Penn Central record finally closed in September, 1964, the Commission within the next year was confronted with three possibilities for restructuring the railroad East—two systems (Penn Central and N&W–C&O proposed by the N&W–C&O application filed October 11, 1965), three systems (C&O–B&O, N&W with possible additions and Penn Central), and four systems (C&O–B&O, N&W, PRR and NYC).

The Department of Justice, representing the Government, was party to the more important merger cases before the ICC in the 1960's. It opposed the merger of the Northern Lines in the West through the Supreme Court. It participated in the *Seaboard Coast Line Merger* case settling how the antitrust laws were to be applied to rail mergers.[109] In *Penn Central*, its position changed from unqualified opposition to the proposed merger at the time of the examiners' report in March 1965 to agreement that the proposed merger was in the public interest before the Supreme Court in 1968. At the time of the initial ICC decision in 1966, the Department was urging a four-system East (PRR, N&W, C&O–B&O and NYC) and that if the time came when four systems could not be supported, then PRR should be consolidated with N&W, and NYC with C&O–B&O.[110]

Whatever the changes in position, the Penn Central merger encountered substantial opposition, that opposition gradually disappeared, and its approval created the present three-system East.

Delay is inevitable in any unification of carriers. In *Penn Central*, the six-year delay gave the two railroad applicants ample opportunity to allay the substantial opposition and provided time to refine their extensive plans for physical merger. However, the realization of economies was postponed, substantial losses continued, plants deteriorated, working capital continued to decline, new rail competitors were solidifying their positions, and so the many pressures induced substantial concessions not only to obtain but also to expedite approval.

Delay did not bring any change in one important respect. The January 1962 merger agreement between PRR and NYC provided for a stock exchange ratio of 1.3 shares of NYC capital stock for one share of PRR capital stock. The initial ICC decision in April, 1966 found that this ratio was fair and reasonable. Maintenance of the ratio influenced the managements of the two railroads in making short term decisions affecting profits. To what extent

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[106] Norfolk & Western Ry. Co. and New York, C. & St. L. R. Co. Merger, 324 ICC 1, 20, 26, 32, 91 (1964).
[107] C&O–B&O case, 317 ICC 326 (1962).
[108] N&W Merger case, 324 ICC 1, at 53–62 (1964).
[109] Seaboard Air Line R. Co. v. United States, 382 U.S. 154 (1965).
[110] Penn Central initial report, 327 ICC 502 (1966).

those decisions weakened the two companies from the standpoints of their financial well being, operating capabilities and physical condition of plant is difficult to determine. In any event, when finally the time for merger came, those in control of the two companies must have concluded that the ratio was reasonable in 1968, and so the 1.3 NYC to 1 PRR stock exchange was the basis of the merger.

Fiscally, the plans called for relatively modest expenditures to integrate these two major systems, and these expenditures would be offset by salvage. The cost of the labor protective conditions was expected to be high, and with the ICC's approval, premerger reserves were established to meet that cost. After years of delay and years of planning, PRR and NYC merged corporations, plants, facilities and personnel on February 1, 1968. The situation called for immediate and effective execution of the extensive plans to achieve the great expectations. In short order, many difficulties appeared, and before long, Penn Central was on its way to disaster.

The ICC recognized the importance of public overview of the merger. On August 19, 1966, while it was reconsidering its initial merger approval issued in April of that year, the Commission required the applicants to file reports designed to keep the Commission completely and currently informed of the progress made by Penn Central in achieving economies and efficiencies after consummation of the transaction. Upon later petition of the Department of Justice, the Commission on May 21, 1968, vacated the 1966 order and required Penn Central to file a "Performance and Status Report" for each of five calendar years beginning with 1968. The new order required the report, among other things, to designate and identify the resulting savings and effects of 27 items among which were the following: (1) elimination and consolidation of offices, departments, divisions, freight stations, terminals, and other facilities, (2) elimination of yards, and efficiencies in the operation of yards, (3) elimination of duplicate freight and passenger train service, (4) change in frequencies of service by routes, (5) reduction in transit time in PC's single-line service as compared to PRR, NYC or combination, (6) maintenance savings resulting from reduced locomotive miles and consolidation of repair facilities, (7) number of employees terminated or relocated in each work classification, with resulting savings in the cost of wages and fringe benefits and with protected allowances paid to such employees, (8) costs under labor contracts, (9) reduction of supplies and inventories, (10) other actions resulting in economies such as maintenance of way methods, (11) net effect on railway operating revenues and on net income for the period of all actions taken under the merger program, and (12) capital improvement projects started or completed and total funds spent.

Penn Central filed two performance and status reports. Both reports disclosed difficulties. The first for 1968 said that temporary impairment of service undoubtedly resulted in loss of traffic volume and produced unusually heavy costs in per diem and overtime payments. It estimated that merger startup costs and losses approximated $75 million. The merged company, the report went on to say, elected to endure high initial costs as the price of accelerated change, in order to realize more quickly its goals of improved service and merger savings in subsequent years.

In the second performance report, which included also the New Haven as part of Penn Central, the records were said to indicate for the year 1969 merger expenses of approximately $37.6 million and merger savings of approximately $51.7 million. This report was filed March 31, 1970, shortly before Penn Central announced its first quarter 1970 consolidated loss of $17.2 million.

By that time, the Commission was acutely aware that Penn Central faced unusual conditions. By application filed September 12, 1969, Penn Central sought authority under ICA § 20a to issue its short-term, promissory notes in the nature of commercial paper in total fiscal amounts not exceeding $50 million outstanding at any one time. The report of the Commission, by Division 3, expressed serious doubts. It pointed out that commercial paper notes are ordinarily drawn for a 270-day or less maturity but that the proposed notes would have a maturity as long as one year from the date of issue. It said that short-term financing has traditionally been relied upon to finance short term needs and is not normally regarded as a proper source of long-term financing of capital expenditures or for the refinancing of maturing long-term debts. It

expressed its concern "about the use of short-term financing for long-term purposes." The report then said, that on the whole, PRR was in a strong financial condition. The Commission concluded that in view of the tight money market and PRR's stated intent to negotiate long-term financing as soon as feasible, the application should be approved.[111]

The ICC by late 1969 knew of Penn Central's service deficiencies and financial problems. Several informal meetings were held, but, except for the May 1968 order requiring performance and status reports, the Commission undertook no formal or informal action of overview until after the bankruptcy in June 1970. What, if anything, continuous and thorough overview could have achieved is an interesting subject of inquiry for imaginative minds. Where specific governmental approval is required by law to merge corporations and their properties engaged in providing service of critical public importance, such as transportation, the duty of overview must certainly fall on some authoritative body. The responsibility for approval of railroad unifications is vested in the ICC and carries with it the duty of overview.

In the post merger period prior to bankruptcy, the longtime atmosphere of conservative policies characteristic of the PRR for over a century seemed still to affect the public view of Penn Central. Except for an on-the-ground inquiry used to produce a financial analysis for brokerage houses, no outside group made any significant investigation of Penn Central and the merger results prior to the critical days in the spring of 1970. Penn Central stock prices had been declining for some time, and accelerated their downward plunge after the announcement of frightful first quarter results in 1970. Rumors of Penn Central difficulties persisted, but the complexities of the critical difficulties were not fully realized.

The result was a major railroad bankruptcy which, without a substantial change in the rules of the game, will likely continue in bankruptcy for many years without any certainty that eventual reorganization will ever occur. With the bankruptcy have come numerous investigations, a multiplicity of law suits, conflicting views of the causes of the bankruptcy, doubts about achieving economies of scale in railroad mergers, and serious damage to the public interest in a sound and efficient system of rail transportation in the Nation and in the East.

To conclude this segment of the report on the Penn Central merger, its approval and its effect, the following points should be noted:

1. *C&O-B&O control approval as determinative.*—The ICC's approval of C&O's control of B&O in December 1962, determined, as a practical matter, the realignment of the Eastern railroads, especially since the N&W merger applications were contemporaneously pending and little opposed.

2. *Little opposition to C&O–B&O and the N&W merger.*—The acquiescence of many affected parties such as competing railroads, the shipping public, states, cities and other community interests, facilitated approval of the C&O–B&O control effected in 1963 and the N&W merger consummated in 1964.

3. *Control of the Eastern rail structure.*—The law made it possible for the PRR system to have the power to veto, if not to control, the ultimate revision of rail facilities in the East. Policy makers may well doubt whether control of the rail structure by one industrial power center comports with the national interest in a sound transportation system.

4. *Effect of merger on Penn Central.*—The Penn Central merger, badly managed and poorly executed, hastened the financial collapse of the new company. The merger, skillfully managed and effectively executed, might have at least postponed the crisis.

5. *Effect of Penn Central denial.*—Denial of the Penn Central merger would have continued a four-system East (C&O–B&O, N&W, PRR and NYC) and delayed the crisis which it appears would have eventually confronted PRR and NYC.

6. *The case-by-case method of merger approval.*—The firm adherence to the case-by-case method of rail merger approvals prevented thorough public consideration of the major merger proposals in the East as related, first, to

[111] Penn Central Transportation Co., Notes, ICC F.D. 25854, decided Oct. 29, 1969, reprinted, Hearings before the Senate Committee on Commerce, *Failing Railroads*, 91st Congress 2d Session; Serial No. 91–90 (1971), pp. 174–175.

national and regional needs for rail service and, second, to improvement of the economic condition of the Eastern railroads generally.

7. Delay.—The extensive opposition to the merger, the inevitable time lag in ICC processes, and the provision of protection for smaller railroads seeking inclusion, resulted in damaging delay. Merger in 1963 or 1964 would have conserved cash and permitted shakedown operations in a more favorable period from a revenue/expense standpoint.

8. Effect of delay.—During the six year delay, PRR and NYC continued past policies to maintain public confidence in the two companies and their proposed merger as planned, but these policies resulted in severe cash losses and likely in serious deterioration of plants.

9. Uncertain national policies.—The uncertainties of national and Government policy on rail mergers contributed to the delay and likely influenced PRR/NYC to make costly concessions.

10. Conditions of approval.—The conditions imposed by the ICC on its approval of the merger proved not to be burdensome, except for the required inclusion of the New Haven and except perhaps for the Appendix G indemnification provisions which discouraged solicitation of competitive traffic subject to Appendix G.

11. Plans for physical merger.—PRR/NYC made extensive plans for physical merger of their facilities. Delay of the merger permitted refinement of those plans. However, they were not properly implemented after the merger. Whether full use of those plans would have facilitated physical merger and prevented the chaos is not known. Even with their extensive planning, the merger partners were, in fact, not prepared to merge their operations and properties.

12. Post-merger overview.—The post-merger overview by the ICC was inadequate. The ICC is not structured, staffed or funded to provide the kind of overview needed to protect the public interest in the effective and economic unification of critically important transport companies.

FISCAL POLICY ANALYSIS

CONTENTS

Financial Situation

FINANCIAL OUTLOOK: INTRODUCTION

The financial environment in which the PRR operated in the years preceding the merger gives an excellent indication of the financial situation carried over to the merged Penn Central. The minutes of a Finance Committee meeting on May 21, 1963 provide an insight into the financial constraints:

> . . . However, the next seven years will be the most difficult from a financial standpoint of any period of the history of the Company. Earnings during the past five years amounted to only $695,000 and there is no assurance of a sudden upturn in net profits. For the years 1952–1962 inclusive, there was a cash loss of about $110,000,000 notwithstanding the receipt of approximately $10,000,000 a year from the sale of real estate. During 1963, based on current estimates, there will be a net cash loss of $20,000,000. At the end of 1962 there was an adjusted working capital deficit of $60,000,000 and at present this deficit is $68,000,000. Provisions will have to be made for maturities during the next seven years of $565,000,000 . . . In addition, the merger with the NYC will require capital expenditures during the first five years of $75,000,000 less $45,000,000 to be provided through salvage. The NYC had an adjusted working capital deficit of $40,000,000 at the end of 1962. Both companies had a net income deficit last year and if there should be a deficit for them again this year, there will be a further cash loss.[1]

This situation did not seem to improve in the next three years, as witnessed by a memo from Bevan to Saunders, dated October 25, 1966:

> . . . Herein lies the truth why today the financial resources of the Company have been stretched further than at any time since I have been with the Railroad. Throughout this entire period, and the last twelve months money has been scarcer than at any other time in my business career . . . The foregoing are the reasons for our present difficulties, but we should also look at some other aspects of the situation:
>
> *Capital expenditures:*[2] . . . We have . . . outstripped the NYC in [capital] expenditures by a wide margin and this is also true for almost any of the other Eastern Roads proportionately, and basically the same may be said on a National basis . . .
>
> *Earnings:* . . . The improvement in our earnings has not been material . . .
>
> *Share of market:* . . . Despite huge sums spent on our equipment during the first six months of 1966 our share of the Eastern markets was 20.1% as compared to a high in the 1960's of 20.9%, in 1962 . . . if even in 1965 we had been able to maintain our position in the Eastern Markets, we would have had over $5 million more in revenue than we did . . .
>
> *New financing ability:* As has been pointed out many times in the past three years, we have reached a danger point with respect to our ability to carry on new financing. At any time, because of the serious maladjustment in the ratio of equipment depreciation to maturities, Moody's may drop our rating from A to Baa, and if this happens our ability to finance equipment, even at a substantially advanced cost, would become extremely difficult if not impossible, in the present tight money market. . . .
>
> In addition, just recently, the Morgan Guaranty Bank which is now a very substantial holder of our stock has manifested a great interest in ob-

[1] Minutes, Meeting of PRR Finance Committee, May 21, 1963, Appendix D, Exhibit 70, p. 730.
[2] Italicized descriptions added for clarification.

taining figures showing projected maturities of PRR in relation to its projected cash flow. . . .

Per diem situation: . . . There has been no noticeable improvement in our per diem situation during the year 1966. . . .

Moody's ratings: The most basic and serious problem has to do with our ratings for Moody's. The greater the increase they see in our debt, the more likely they are to analyze our equipment situation and the more vulnerable we are to having our ratings decreased.[3]

The problems presented above are certainly more serious than anyone outside of top management realized at the time. It is these financial problems, coupled with the merger agreement limitations and the labor agreement signed by Saunders and Perlman, which made the financial plans of the PRR and later the Penn Central reactive, rather than proactive. The basic problems seemed to be whether the PRR would be able to fund its operations, debt maturities, equipment policies, etc., until the merger could be consummated, and then whether the anticipated merger savings would be realized soon enough to provide sufficient funds from operations to sustain the Railroad's heavy fixed requirements and debt maturities.

FINANCIAL POSITIÉON

The merger agreement between the NYC and the PRR provided that the debt of neither of the railroads could be increased by more than $100 million prior to the consummation of the merger. This agreement placed harsh constraints upon both of the railroads, since it was six years between the time when the merger agreement was signed and the merger was consummated. Further, Saunders and Perlman signed a labor protection agreement with the major railroad labor unions in May 1964. The costs of this agreement were estimated at that time to be $2.8 million, $16.5 million, and $25.2 million, respectively, for the first through the third years of the merger.

The delay involved between these agreements and the merger changed a number of the estimated costs and benefits presented to the ICC in the early 1960's. The labor agreement escalated from a total cost of $78.2 million to $195.2 million. The anticipated capital expenditures necessitated by the merger due to obsolescence of certain facilities, and for the consolidation of others, resulted in large discrepancies between the actual costs and the initial estimates.

Confronted with underestimated merger costs and overestimated merger savings, as well as poorly maintained track, roadbeds, and rolling stock, the Railroad had to spend massive sums of money after the merger to modernize facilities, maintain the tracks and roadbeds, and provide for very costly labor agreements. Even before the merger, the PRR undertook a massive capital expenditure program to improve its facilities. But it had to do all of these activities without increasing its debt by more than $100 million. (This agreement was later modified and the debt limitation was increased to $195 million.)

Bevan had indicated that the environment in which he had to finance the Railroad's programs in 1963 was limiting, at best. He could not increase debt by more than $100 million because of the merger agreement; but even if he had not faced that constraint, Moody's would have investigated the PRR much more carefully if the debt structure of the Railroad increased much more than its 1963 levels. In addition, Morgan Guaranty and Trust was interested in the cash flows from operations and the debt maturities projections, a careful analysis of which could have had a disastrous impact on the PRR's future financing ability.

In light of this debt constraint, the PRR and later the PCTC made extensive use of equipment leases. The advantages of leasing are that it does not necessarily require a cash down payment, it is not shown on the balance sheet, and the total financing costs of such leases[4] are not significantly different from more conventional forms of equipment financing. Also, the investment tax credit applicable to such equipment could not be used by the Railroad directly,

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[3] Memo from Bevan to STS (Saunders), October 25, 1966; see Appendix D, Exhibit 36, p. 554.
[4] Memo from DCB (Bevan) to STS (Saunders), August 31, 1966; Appendix D, Exhibit 71, p. 731.

since it had huge tax loss carryovers, but could be used by the lessor in return for more favorable leasing terms.

The obvious advantage of leasing is that it does not change the debt-equity ratio of the Railroad, since it is not capitalized. Another important factor is the "analysts' rule of thumb" in analyzing the Railroad: "When equipment maturities equals equipment depreciation, you are in balance, anything above, you are in trouble".[5] The PRR was not in a good position in this regard, since its ratio of equipment maturities to depreciation for 1966 was greater than unity, while the NYC's was less than unity.[4] The important point is that the PRR was obliged to use leasing to maintain the existing ratios on its balance sheet, even though these existing ratios indicated a marginal operation. The NYC was confronted with similar problems, and correspondingly made increasingly greater use of lease agreements during the 1960's. An indication of the degree of lease utilization appears in the following table. The effect of the leasing practices was to mislead the investing and financial community by showing a better balance sheet, but the effect of this policy on the income statement is negative. The lease expense is composed of principal and interest, both of which are shown on the income statement. If the equipment were financed by serial bonds, only the interest would appear on the income statement, the principal would not appear anywhere after it had been paid. Thus the income statement would show net income as being less than it would have been had the Railroad chosen to finance equipment purchases by the use of serial bonds.[6]

PENN CENTRAL TRANSPORTATION CO.[1]—EQUIPMENT LEASING AND CAPITAL EXPENDITURES 1963-69

[Dollars in thousands]

Year	Capital expenditures [2]		Leasing [3]	Total	Percent leasing
	PRR	NYC			
1963	$17,354.1	$14,159.2	$36,303.3	$67,816.6	53.5
1964	66,381.9	55,829.2	12,466.3	134,677.4	9.3
1965	160,189.3	53,818.1	69,781.3	283,788.7	24.6
1966	144,693.9	39,101.7	27,063.9	210,859.5	12.8
1967	59,022.2	41,038.7	72,616.0	172,676.9	42.1
1968	96,217.6		93,428.8	189,646.4	49.3
1969	86,041.0		71,208.1	157,249.1	45.3
Total	629,900.0	203,946.9	382,867.7	1,216,714.6	
Average	89,985.7	40,789.4	54,695.4	173,816.4	
Percent of total	51.77	16.76	31.47	100.00	

[1] After 1967, P.RR. and NYC figures are combined.
[2] Source: Moody's Transportation Manuals.
[3] Source: Table: Equipment Lease Agreements; see Appendix D, Exhibit 49, p. 614.

SOURCES OF FUNDS

The PRR had been liquidating some of its real estate holdings for at least 15 years prior to the merger. Bevan indicated that such liquidations brought about $10 million per year in additional cash from 1952–1962.[7] Such holdings were liquidated when they not only brought a cash inflow into

[5] The "equilibrium" is that point at which the maturities can be met with internally generated funds. Since depreciation is a noncash expense, if a railroad's revenues and expenses are exactly equal, it has funds equal to the amount of noncash expenses, depreciation, to pay the maturity. Also, equipment obligations are usually serial bonds, paid over a 10–15-year period (the useful life of the asset). Depreciation is the systematic allocation of the cost of an asset to expense over its estimated useful life. A balance of these two figures implies that financing has been arranged such that the rate of payment on the bonds is equal to the estimated loss of service potential of the assets. In essence, the cash payment for the asset equals the service potential of the asset consumed. While there are theoretical flaws in this argument, this rule of thumb is valid for approximation purposes.

[6] It must be noted that theoretically, the net effect on the income statement over the entire life of the lease would be zero. The equipment depreciation would offset the total amount of the repayment of principal had the equipment been financed by serial bonds. The only income statement effect would be a smaller equipment depreciation expense, and a larger fixed charge over the entire life of the lease. In the case of the Penn Central, however, such was not necessarily the case. In the sales-leaseback arrangements of rolling stock, the Penn Central would consistently overestimate the cost of rehabilitating the equipment, while receiving the total amount of estimated repair costs in cash at the time of repair. The difference between the actual expense and the amount received could be used for general corporate purposes. The lease payments would reflect this higher repair cost. *But*, depreciation is only allowed on the total cost of the equipment; thus depreciation expense, in total, would be less than the portion of principal repayment by the amount of the difference between the estimated and actual rehabilitation costs.

[7] Minutes, meeting of PRR Finance Committee, May 21, 1963; Appendix D, Exhibit 70, p. 730.

the Company, but especially when they also brought a profit on their disposition. By 1966, profits from the disposition of these holdings were becoming scarce. While cash was generated from their sale, there were fewer gains on the disposition, such that net income was not increased. Some of the sources of funds from 1967–1969 are detailed in the table below. This is not intended to be a comprehensive analysis of all asset and security dispositions, since such information is not readily available.

PENN CENTRAL TRANSPORTATION CO., ASSET AND SECURITY DISPOSITIONS—CASH EFFECT

[Thousands omitted]

Source	1967 [1]	1968 [2]	1969
Property sales	$19,650	$59,700	$54,600
Securities sales	2,444		
U.S. Government bonds	1,066		
Total	23,160	59,700	54,600

[1] P.RR. only.
[2] PCTC only.

The Railroad relied to some degree on the sale of its assets to provide funds, and placed even more emphasis on transactions with the Pennsylvania Company to purchase securities from it in order to provide cash for the Railroad's operations. This is discussed at length in another section. After the merger, a program was instituted to generate cash from the sale of inventory, scrap sales in excess of normal, and the deferral of road improvements and decreases in estimated capital expenditures. In addition, when the cash situation became critical, purchases of operating supplies were deferred until the Railroad was in a better cash position.

The Railroad could finance its equipment programs by leasing, equipment trust certificates, or conditional sales agreements. However, the capital expenditures for road and track could not be financed by these methods, because the asset would not be accepted as security for the loan, since it was not easily removable nor easily resold. This required that the funds spent on this type of capital improvement be generated from operations, or provided from debt financing with equipment used as collateral for the bonds.

To provide the required funds, long term financing was augmented by the issuance of commercial paper, revolving credit agreements, and other short term financing. The external sources of funds provided by such financing for the years 1968–1969 are as follows:

PENN CENTRAL TRANSPORTATION CO.

SOURCE OF EXTERNAL FINANCING TRANSPORTATION COMPANY ONLY

[In thousands of dollars]

	1968	1969
Equipment:		
Conditional sales agreements	76,000	74,800
Leasing agreements	104,000	86,900
Bank loans	130,000	155,300
Advances from subsidiaries	22,000	84,000
Total	332,000	401,000

The extensive use of revolving credit agreements and commercial paper was a short term solution to a long term problem. In May, 1969, Bevan negotiated a new loan and revolving credit agreement with a number of banks led by First National City Bank of New York. Prior to this agreement, PCTC had $50 million outstanding, and with the renegotiation it immediately drew upon another $50 million, the limit of the debt agreement.

In April 1969 the agreement was renegotiated, with the amount of credit available increased to $300 million. The PCTC was also using commercial

paper as a means of financing; $100 million in 1968, $50 million in March 1969, and another $50 million in November, 1969. The ICC had to approve the issuance of commercial paper, and each time the amount PCTC issued increased, it required separate ICC consent. The biggest problem with the commercial paper is that while the interest rates are comparable with short term bank borrowings,[8] the paper must be rolled over frequently, since it is issued for a very short term. The inability to meet these obligations or roll over the commercial paper was a major factor in the reorganization decision.

Bevan also used a "blanket" mortgage of up to $300 million to provide funds for the Company. When the PCTC wanted to issue further bond offerings in early 1969, it became apparent that PCTC would not be able to sell the securities due to the bond market conditions. At this juncture, he hoped to have the Pennsylvania Company issue $35 million of Collateral Trust Bonds, which was successful at an interest rate of 8¼% using $100 million of Buckeye Pipeline Common stock as collateral. Late in 1969, the Pennsylvania Company issued $50 million convertible bonds at 9%, convertible into stock held by that Company as an investment. In the Spring of 1970, Bevan hoped to issue a $100 million bond offering of the Pennsylvania Company, but the excessive losses of the Consolidated Penn Central and the non-consolidated Transportation Company made that offering impossible. This money was desperately needed to fund the maturing commercial paper and equipment trust maturities. When it could not be issued, the PCTC filed for reorganization.

FINANCIAL POSITION: ANALYSIS

The merged Railroads had a very high debt/equity ratio even before operations began in February 1968. The extensive use of leasing minimized some of the effects of the rapidly increasing debt, but also had a negative effect on net income in that the principal was included as a cost of operation. The huge cash losses of the Transportation Company, the massive capital expenditure program undertaken by the Railroad, and the excessive dividend and diversification policies made the need of external financing all the more imperative.

It could be said that Bevan relied too heavily on debt instruments; but after the merger had been consummated and the results of operations became known, he had little alternative. The financing options were severely limited by the huge losses of the Transportation Company, which could not be offset by improved earnings of the subsidiaries. At the time of the merger, an equity issue could have had success in the financial markets. A wave of optimism (relative to past evaluations of the individual railroads before the merger) was present in the financial community in anticipation of the merger savings to be realized by the Transportation Company. This is evident from the evaluation (in terms of common stock earnings and dividends) of the pre-merger railroads, and the post-merger Penn Central by Standard and Poor's. Prior to the merger, both the New York Central and the Pennsylvania were ranked B minus (the next to lowest ranking given to common stocks by Standard and Poor's). After the merger, however, the Penn Central was given a ranking of B, even though there had been no change in any of the indicators used in determining the ranking.[9] The only apparent rationale for the upgrading was the optimism with which merger savings were anticipated. But those savings never materialized. After the operating losses of the merged railroad became known, an equity issue would not have been possible. Had the Penn Central actively pursued the possibility of an equity issue, then further defense could be made of the excessive post-merger dividend payments.

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[8] Initially the rate was lower than short-term bank loans, but after mid-1969, commercial paper was more costly.

[9] Standard and Poor's Stock Guide, Standard and Poor's Corporation, 345 Hudson Street, New York, N.Y.

It must be noted that Standard and Poor's does not attempt to evaluate stock *quality*, but rather their ratings attempt to indicate the stability of growth of earnings and dividends using a mathematical formula which weighs dividends and earnings separately, giving greatest emphasis on the most recent years, and then combines these separate evaluations to give an overall ranking.

While Bevan used every option that he could to provide funds through debt issues in hopes of keeping the Railroad alive until merger savings could offset additional merger costs, he had created a debt structure that had to spell doom. The equipment maturities that existed as of the end of 1969 would require $997.4 million by 1976, a sum that would require a strong improvement in the operating performance of the Railroad. Additionally, approximately $60 million per year was required for the lease agreements, there was $200 million in commercial paper outstanding and $300 million in revolving credit agreements. These obligations alone amount to the staggering sum of $1,917,404,000, and this does not include the other fixed obligations, such as interest on this debt. It is quite questionable that anything could have kept the Railroad from reorganization, its capital structure was simply too debt laden.

ACCOUNTING PRACTICES AND POLICY

As has been cited previously, the Penn Central employed many questionable accounting techniques to maximize its reported net income and improve its financial ratios. Observations concerning general accounting policy can be made about the failure of the ICC to thoroughly investigate the financial reports submitted by the Penn Central. But the most significant general accounting policy implications relate to two other areas. The first concerns accounting policies prescribed by the ICC and followed by the Penn Central which affected their operating decisions. The second area is the lack of uniformity between regulated accounting and "Generally Accepted Accounting Principles," such as those promulgated by the Accounting Principles Board of the American Institute of Certified Public Accountants.

Before discussing the differences between "Generally Accepted Accounting Principles" (GAAP) and ICC accounting policies, a review of the nature of uniform accounting rules and the economic environment of the transportation industry is in order. The Accounting Principles Board was established to provide criteria by which accountants could audit corporate records and certify financial statements. The audit certificate declares that the financial reports present *fairly* the financial position of the company, in accordance with generally accepted accounting principles and consistent with the prior period's method of presentation. The principles established were necessarily broad in scope, giving much latitude for handling certain transactions, because of the wide variety of situations which occur in American Industry. The principles constitute "substantial authoritative support" for a particular method of accounting for a transaction. However, these principles recognize existing regulatory accounting procedures as constituting such "authoritative support," and permit those regulatory agencies to dictate accounting procedure in regulated industries.

ICC accounting principles were originally established in the first part of this century, to provide a standardized method of accounting for transactions within regulated industry. Such procedures, however, have in many cases not kept pace with the dynamic nature of the transportation industry, and are in need of revision. The railroad as a single corporate entity is rapidly becoming the exception. The transportation holding company, with many subsidiaries in a diversity of industries, is becoming much more common, with attendant accounting complexities of fairly presenting the financial position of such a broadly based corporation.

ICC accounting policies relied heavily on the single industry nature of transportation companies for providing the rationale for specific, stringent accounting procedures. Such procedures have the distinct advantage, in theory, of narrowing the acceptable methods of accounting for specific transactions, thus providing greater control for the regulatory agency as well as greater consistency in financial reporting. However, the multi-industry nature of many transportation companies has made the accounting process more complex, while regulatory accounting policy and procedure has not responded adequately to this increase in complexity. It is clearly incumbent upon the ICC to provide changes in its accounting policies to meet the new demands of the industry it is regulating.

Divergence in regulatory accounting techniques from GAAP is justified when the advantages of greater control and specificity afforded by regulatory accounting policies outweigh the loss of comparability between regulated and nonregulated industries. There are certain situations, however, where regulatory accounting practices have not adequately met the demands of the changing nature of the transportation industry, and where the divergence from GAAP is not substantiated by increased control and specificity in the financial reporting process.

The ICC has taken the position that a transportation company may use GAAP in reporting to the stockholders, provided that any differences between the results filed with the ICC and the results presented to the stockholders be adequately disclosed in the financial statements. This seems to be a reasonable alternative, in that control is provided over the accounting practices used in reports to the ICC, while the investors can obtain all the information necessary to convert the statements to reflect the results using GAAP. For example, the Penn Central disclosed the amount of deferred income taxes that would have increased "earnings from ordinary operations by $1,500,000 ($.06 per share) and reducing the extraordinary charge by $22,500,000 (.93 per share); and in 1968 would have had the effect of decreasing earnings from ordinary operations by $8,000,000 ($.35 per share)." This information has been presented, but the question is whether it can be understood by the average investor.

Financial statements are confusing enough to the average investor, and differences cited in the footnotes between alternative accounting methods quite probably do not clarify the report, rather they tend to cloud the issue of the financial performance of the company by presenting too much conflicting and technical data.

Major differences between ICC and GAAP

One area of divergence of GAAP and regulatory accounting procedure concerns the recognition of deferred income taxes. GAAP requires a company to show, as a current expense, deferred income taxes, while regulatory accounting does not allow such a recognition. Deferred income taxes result from differences between net income reported to investors and the net income used for income tax purposes. The most prominent situation in which such differences occur is the use of straight line depreciation for financial reporting purposes and accelerated depreciation for income tax purposes. For the first few years after the acquisition of assets eligible for accelerated depreciation, accelerated depreciation expense will be greater than straight line depreciation. Thus, net income for financial reporting purposes will be higher than the taxable net income for income tax purposes. The difference in net income is the amount of difference between the accelerated and straight line depreciation.

Assume, for illustration purposes, that an asset is acquired by a railroad for $100,000, has a salvage value of $10,000, and an expected life of 5 years. The depreciation expense for the life of the asset is shown in the table below.

COMPARISON OF STRAIGHT LINE AND ACCELERATED—DEPRECIATION METHODS

Year	Straight line depreciation	Accelerated depreciation	Difference	Deferred income taxes for year [1]
1	$18,000	$40,000	$22,000	$11,000
2	18,000	24,000	6,000	3,000
3	18,000	14,400	(3,600)	(1,800)
4	18,000	8,640	(9,360)	(4,680)
5	18,000	2,960	(15,040)	(7,520)
Total	90,000	90,000	0	0

[1] Assumes a 50-percent tax rate and no other tax minimize policies followed.

Accelerated depreciation is larger than the straight line depreciation for the first two years, the total deferred income taxes for this period represent the decrease in income taxes payable for that period. GAAP requires that the income tax expense reflect the amount that would have been payable had the ac-

celerated method not been used for tax purposes. That is, the current federal income tax *expense* would be shown as the actual tax payments *plus* the deferred income taxes for the year. ICC accounting requires that the income tax expense reflect the actual amount paid to the government, without any provision for recognizing the deferred portion. Thus, if after tax net income before deferred income taxes on the published financial statements was $50,000 for each year, the difference in after tax net income under regulated and GAAP accounting would be as follows:

Year	After tax net income before deferred income taxes	After tax reported net income in published financial statements	
		GAAP	ICC
1	$50,000	$39,000	$50,000
2	50,000	47,000	50,000
3	50,000	51,800	50,000
4	50,000	54,680	50,000
5	50,000	57,520	50,000
Total	250,000	250,000	250,000

Several observations must be made about the above example. First, the *total* reported net income resulting from both methods of accounting for deferred income taxes will be the same, the increased deferred income taxes in the earlier periods are actually offset by decreased deferred income taxes in later years. The second observation is that the *total* income taxes *paid* are also the same. The difference results from the timing of reported expenses for income tax purposes. It would seem, on the surface, that the ICC method provides for less erratic reported after tax net income. It must be noted, however, that the decreased deferred income taxes in the later years is offset by increased deferred income taxes due to more recent property additions. Thus deferred income taxes, in effect, do not decrease in later years where the railroad is maintaining or increasing its rate of capital expenditures.

The problem presented above is one of interperiod tax allocation; (i.e. income and expenses are reported in different accounting periods for financial reporting and income tax purposes). The question is which method should be used to present the income tax expense on the income tax statement.

The accounting profession has debated this problem for more than a decade, and finally, in December 1967, the Accounting Principles Board (APB) issued Opinion Number 11, which discussed this problem. The contents of this opinion will be examined subsequently. It will be necessary to first consider some of the accounting problems associated with the question of deferred income taxes. There are basic differences between the goals of financial accounting and the goals of the Tax Laws. The former is concerned with a fair presentation of the financial position of the company, while tax law is concerned with economic effects of fiscal policy and the intentions and goals of Congress, as well as the taxation of reported income.

Financial accounting, in conformance with GAAP, is much more concerned with conservatism and the matching of revenues and expense. The matching principle implies that revenues be reported in the period in which they are earned and that the costs associated with the generation of that revenue be recorded in the same period as the revenue. Stated differently, the resources of a company (its assets) are consumed to generate sales or revenues. The consumption of these resources become expense when the revenue is generated. By recording the costs and expenses in the same accounting period, a measure of the performance of the company is derived, this measure conveniently called "income." While the complexities of business transactions cause certain departures from this basic tenet, this is a central concept in "Generally Accepted Accounting Principles."

Recognizing deferred income taxes is an extension of the matching principle. In essence, the tax payments that result from the net income of the period (the revenues less the expenses that generated the revenues) regardless of when

the taxes are *actually paid* should be considered a legitimate expense of the period. Thus, the current and deferred income tax should be considered as part of the *current* costs of generating revenues. Deferred income taxes are simply timing differences; the taxes will have to be paid in the future instead of the current period. But this does not necessarily imply that the taxes will not have to be paid ultimately.

George M. Stafford, Chairman of the Interstate Commerce Commission, responding to a letter from the Honorable Harley O. Staggers of the House Committee on Interstate and Foreign Commerce discussed the position of the ICC with respect to the question of recognition of deferred income taxes: [10]

> In 1960 the ICC instituted rulemaking procedure relating to the applicability of its accounting rules to financial statements of carriers contained in reports to stockholders or otherwise released to the public. By report and order dated January 25, 1962, in Docket No. 33581, *Financial Statements Released by Carriers*, it found that, 'Carriers desiring to do so may prepare and publish financial statements in reports to stockholders and others, except in reports to this Commission based on generally accepted accounting principles for which there is authoritative support, that any variance from this Commission's accounting rules contained in such statements is clearly disclosed in footnotes to the statements.'
>
> From the foregoing, it can be seen that, although the ICC does not permit carriers to record provision for deferred income taxes in its accounts, the effect of the various accounting methods permitted for income tax purposes is clearly disclosed in annual reports filed with us and in reports to stockholders and others. Of course, the basis of the ICC ruling is 'the present day shipper should not be required to provide from current freight rates for possible increased tax rates of the indefinite future'.[11]

The ICC study, referred to in the above paragraph, is presently over 10 years old, and was written before the Accounting Principles Board issued its Opinion Number 11, which considers all of the opinions considered in the ICC study. The opinion of the APB appears, in part, as follows:

> The Board has considered the various concepts of accounting for income taxes and has concluded that comprehensive interperiod tax allocation is an integral part of the determination of income tax expense. Therefore, income tax expense should include the tax effects of revenue and expense transactions which enter into the determination of pretax accounting income. The tax effects of those transactions which enter into the determination of pretax accounting income either earlier or later then they become determinants of taxable income should be recognized in the periods in which the differences between pretax accounting income and taxable income arise and in the periods in which the differences reverse.
>
> . . . The Board has concluded that the deferred method of tax allocation should be followed since it provides the most useful and practical approach to interperiod tax allocation and the presentation of income taxes in financial statements.[12]

It must be noted that the opinion presented above makes exception to the applicability of this opinion to regulated industries, as provided for in the Addendum to APB Opinion Number 2, which states:

> However, differences may arise in the application of generally accepted accounting principles as between regulated and non-regulated businesses, because of the effect in regulated businesses of the rate making process, a phenomenon of the rate making process, a phenomenon not present in non-regulated businesses. Such differences usually concern mainly the time at which various items enter into the determination of

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[10] *Penn Central Transportation Company: Adequacy of Investor Protection*, Hearing before the Special Subcommittee on Investigations of the Committee on Interstate and Foreign Commerce of the House of Representatives, September 24, 1970, pp. 137–162.

[11] Ibid., p. 146.

[12] *Opinion Number 11, Accounting For Income Taxes*, issued by the Accounting Principles Board of the American Institute of Certified Public Accountants, December 1967.

net income in accordance with the principles of matching costs and revenues. For example, if a cost incurred by a regulated business during a given period is treated for rate making purposes by the regulatory authority having jurisdiction as applicable to future revenues, it may be deferred in the balance sheet at the end of the current period and written off in the future period or periods in which the related revenue accrues, even though the cost is of a kind that would be written off currently in a non-regulated business.[13]

The ICC position, cited previously, that "the present day shipper should not be required to provide from current freight rates for possible increased taxes in the future" supports the "flow through" method of handling deferred income taxes, that is, taxes become expense only as they become due. It considers that the decreased income taxes, due to the use of accelerated depreciation, really is a reduction in the tax rate, rather than a reduction in taxable net income. It would seem that the alternative treatment, the recognition of deferred income taxes, provides a closer association of revenues with the costs associated with generating those revenues. The tax difference is due to a managerial decision to file their income tax return using a tax reducing option, it is not due to a change in the tax rate.

Another important consideration in the differences between ICC and Generally Accepted Accounting Principles is the different way of recording certain additions to property and plant. There are two areas in which accounting policy affected the operating decisions of the Penn Central, the installation of new non-depreciable property, and the improvement of non-depreciable property. It must be noted that, in certain circumstances, the regulated accounting policy is not in absolute contradiction to Generally Accepted Accounting Principles, rather it is an archaic version of GAAP.

Consider the situation in which a railroad wishes to add new track to its system in the form of a branch line that will be used to connect a main line to a warehouse. Further, let us assume that the warehouse will be removed in 20 years.[14] ICC accounting prescribes that the track, ties, most grading costs, etc., should not be depreciated. Rather, upon retirement of the branch line, the entire capitalized, non-depreciable cost is to be written off against income. Let us further assume that the cost of this branch line is $200,000. Current accounting practice in non-regulated industries would require the cost of the branch line to be allocated, as expense, to the income statement (depreciation). This would reflect the true cost of generating revenue by the asset (the matching principle). In this illustration, annual straight line depreciation would be $10,000 ($200,-000/20 years, assuming no salvage value). Thus, net income for the period would be decreased by the amount of depreciation, which is $10,000. At the end of the 20-year period, when the warehouse is removed, the abandonment of the track would result in no charge to the income statement, since the entire cost of the track would have been "expensed" in the form of depreciation. That is, there would have been no "service loss" on the retirement of the track.

Let us now consider the revenue generated by the branch line. Assume that the total revenues per year were $100,000, and that operating costs, exclusive of depreciation, were $75,000. The net income under nonregulated accounting practice would be $15,000 (revenues-expenses-depreciation equals net income).

Now consider the same example using regulatory accounting policies. The revenues would still be $100,000 per year, and the expenses (exclusive of depreciation) would still be $75,000, but there is no depreciation charge; thus reported net income would be $25,000. Net income is increased by the amount of depreciation which is not allowed under ICC regulation. This seems fine, until the 20th year comes, in which case there is an abandonment charge (or service loss) of $200,000, the entire amount of the cost of the branch line. The statements for the 20 years would be as follows:

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[13] *Opinion Number 2, for the Investment Credit,* December, 1962.

[14] A life of 20 years is used for descriptive purposes, the exact life of the branch line is of minimal consequence, under ICC accounting, until the line is retired.

COMPARISON OF ACCOUNTING METHODS

Year	GAAP	ICC
1:		
Revenues	$100,000	$100,000
Operating expense	75,000	75,000
Depreciation	10,000	0
Total	15,000	25,000
2:		
Revenues	100,000	100,000
Operating expenses	75,000	75,000
Depreciation	10,000	0
Net income	15,000	25,000
19:		
Revenues	100,000	100,000
Operating expenses	75,000	75,000
Depreciation	10,000	0
Net income	15,000	25,000
20:		
Revenues	100,000	100,000
Operating expenses	75,000	75,000
Depreciation	10,000	0
Retirement of Track	0	200,000
Net income (loss)	15,000	(175,000)
Cumulative net income	300,000	300,000

From the above table, it is seen that the net income over the entire life of the branch line is the same, regardless of what depreciation method is used. However, the $175,000 loss at the end of 20 years under ICC accounting methods produces a strong incentive for management not to abandon track to avoid the service loss. The implication in the Penn Central case was that there were a number of miles of track that were not abandoned (to avoid excessive charges against net income) at the expense of the salvage value of track, which would have represented a cash inflow to the cash starved Transportation Company. As is also seen, there is an artificial overstatement of net income for each of the first 19 years of operation of the branch line. This violates the matching principle, discussed in the preceding section, since it does not accurately allocate costs to expense in the period in which the revenues associated with those costs were generated.

The effect on Penn Central was to encourage management to act in a manner that was not in the best economic interests of the railroad; the main inducement was avoidance of an accounting charge. Thus, cash was foresaken to maximize net income.

It must be noted that this accounting policy does not directly contradict Generally Accepted Accounting Principles, rather it is an outmoded accounting principle that has decided disadvantages to managerial decisions. It must be noted that there would be problems in changing the present ICC system of accounting to the more Generally Accepted Accounting Principle of systematic, straight line depreciation. Principally, this problem is that the past charges for depreciation which were not taken by the railroads on track and road bed structures now in service would be enormous, seriously affecting the earnings of every railroad, and significantly distorting long run time series data on depreciation and net income. The GAAP depreciation method would increase annual depreciation charges and thus lower net income, making financial analysis over extended periods a difficult, if not impossible task.

The history of this "non-depreciation" concept is founded upon the limited ability of railroads to process the massive amounts of information necessary to maintain adequate records for depreciation purposes. In the days of automated data processing, however, such an argument is hardly valid. Further, there is the very real problem of determining the real economic life of an asset such as a mainline, or a graded roadbed. This argument can be easily refuted by referring to the Accounting Principles Board Opinion Number 17, in which the economic

life of intangibles (good will, for example) is deemed to be their estimated economic useful life, up to a maximum of 40 years. This opinion discusses the mandatory amortization of intangibles acquired after October 31, 1970, while intangibles acquired prior to that time do not have to be amortized. The analogy that can be drawn is that an attempt to estimate economic life is better than no estimation at all, especially if there is a reasonable maximum limit placed on the asset in question. The need for this estimate is central to allocate cost to expense (depreciation), over a reasonable period of time.

The depreciation problem is compounded by the ICC position toward betterments. Betterments are defined as the replacement of physical property with property possessing greater quality. For example, the replacement of 56# track with 112# track is a betterment, due to the improved "quality" of the replacement. If the railroad has, on a given segment of track, 56# track presently in service, and assuming this track cost $75 per unit when it was installed at the turn of the century this track would not be depreciated, but would remain on the books at its cost of $75 per unit.

Now assume that in 1970 that railroad replaced the 56# track with 112# track, which cost $280 per unit. The effect on the books would be that $140 would be capitalized, and $140 would be charged as expense. The reason for this is that the difference in quality is all that can be capitalized. Since the "quality" went from 56# to 112#, only the *additional* 56#, at current costs, can be capitalized. Thus, the capitalized value of track (originally capitalized at $75 per unit) would be increased to $215 per unit, the increase of $140 due to the current cost of the increased "quality" of the track. The other $140 would be charged against expense. The effect is that the asset value of the track is understated by $65 per unit, and expense is overstated by $65.

The implications of this for management become very clear when it is seen that an addition to track of improved quality results in a charge to expense that is overstated because the old track is not retired (and charged to expense) and the cost of the new track is not completely capitalized. Referring to the original problem of depreciation, if the track structures were depreciated, the resultant extraordinary charge against income for the retirement would be even less, since the bulk of the cost of the original track would have been systematically depreciated over the 70 years it had been in service. (The track probably would have been fully depreciated in that amount of time, depending on the estimated service life of the track when it was placed in service.)

A third area of distinction between ICC accounting and GAAP is the treatment given to investments in subsidiaries. ICC policy requires all investments to be carried under the "cost" method, while GAAP requires that under certain general conditions, investments in companies be carried under the "equity" method. An explanation of the mechanics of these differing procedures reveals this difference.

The cost method maintains the legal distinction between the parent and the subsidiary. (It should be noted that the cost method also applies to investments in corporations in which less than 50 percent of the outstanding voting stock of the company has been acquired.) In the case where 50 percent or more of the common voting stock has been acquired, the cost method provides that the recorded value of the investment in the subsidiary be maintained, *on the parent company's books*, at the initial cost of the securities, not adjusted for dividends paid to the parent by the subsidiary. The investment is not reduced by the payment of dividends. Instead, the income of the parent is increased by the amount of the dividend. It must be noted that the cost method does not provide for recognition of the parent's share of the net income or loss of the subsidiary in the investment account of the parent's books.

If less than 50 percent of the voting stock of a corporation is acquired, on a long term basis, the treatment is exactly as described above for greater than 50 percent ownership, except for the very minor difference of segregating under "Long Term Investments," on the parent's books, the investments in affiliates of 50 percent or more and investments of less than 50 percent. Common to both "controlling" and non-controlling ownership is the parenthetical inclusion of the market value of the securities if such information is available. The invest-

ment account is reduced for the decreased market value of the investment only when such a decrease is significant and believed to be "permanent". Permanent in this sense means that the market value is below cost by a significant amount, and is expected to have such a reduced value for at least the next several years.

The "equity" method of handling securities reflects the parent company's pro rata share of the net income or loss of the company in which the investment was made. Dividends do not increase income as they do in the case of the cost method, but rather represent a return of the investment. In essence, the equity method provides that the parent should recognize the change in the net worth of the subsidiary subsequent to the date of acquisition. The table below summarizes the differences between the cost and equity method as it is carried on the books of the parent company.

COST AND EQUITY METHOD OF ACCOUNTING FOR INVESTMENTS IN SUBSIDIARIES COMPARED

	Parent company's books only	
Event	Cost method	Equity method
1. Purchase of 90 percent of a company for $1,000,000.	Investment increases by $1,000,000	Investment increases by $1,000,000.
2. Company reports $100,000 income for the period after the acquisition.	There is no recognition of this event on the parent company's books.	Investment in the company is increased by $90,000 ($100,000 times 90 percent), and net income is increased by corresponding amount.
3. Company pays a $50,000 dividend on its common stock.	Dividend income is increased by $45,000 ($50,000 times 90 percent) and cash or dividends receivable is increased.	Investment in the company is decreased by $45,000 and cash or dividends receivable is increased by that amount.
4. Company reports a $10,000 loss for the period.	No recognition of the event	Investment in the company is increased by $9,000 ($10,000 times 90 percent) and net income is decreased by that amount.

It should be noted that there are differences in the balance sheet of the parent company depending on which method is used. The cost method does not recognize the income of the subsidiary as a decrease in the investment by the parent, but recognizes the distribution of earnings, in the form of dividends, as income to the parent company. Recent Accounting Principles Board Opinions have dictated that the equity method be used in accounting for investment in which only 20 percent of the ownership is controlled by the investing company.

The controversy of cost versus equity is becoming even more important because of the even greater tendency of railroads to form holding companies, in which extensive investments in other companies are becoming commonplace. The cost method, by virtue of the fact that the earnings of the subsidiary are not recognized, provides a degree of conservatism in that only dividends are considered income. However, the disadvantage is that subsidiaries' losses are not recognized either, so that a parent whose subsidiaries had significant losses in a given period would not reflect the poor performance of these subsidiaries.

The equity method considers that the economic performance of the subsidiaries is a reflection of the current performance of the parent company, and should therefore be reflected in the income statement of the parent. This method considers that the entire entity, parent and subsidiaries, is one economic unit, and that part of the parent company's assets are diverted into subsidiaries for the purpose of generating a return on that investment. Thus, the recognition of the income of the subsidiaries reflects the return on the assets of the parent invested in the subsidiaries. The difficulty with the equity method is that the earnings of the subsidiaries are not necessarily available to the parent, for its own use, in the form of cash. This was seen in the Penn Central case in its investment in Great Southwest and Macco. Thus, it is possible that the equity method would have improved the financial performance of the Pennsylvania Company, even though the increased income would have reflected little real improvement in the financial/economic reality of the Pennsylvania Company. The ICC is engaged in a study of the equity versus cost method of accounting for such investments, and recommendations concerning the merits of two are withheld pending the results of that study.

It may well be said that, in some cases, accountants play the "numbers game;" a game that is not well understood by the average investor. The Accounting Principles Board recently issued a number of Opinions on varied topics, prescribing "Generally Accepted Accounting Principles." But, these Opinions are considered to be only one of several possible treatments of a given economic situation. The Accounting Principles Board states that the Opinions they issue constitute substantial authoritative support for the method of accounting, but also recognize that the dynamic nature of accounting, and the characteristics of particular situations may obviate the accountant from using their published accounting method provided that there is substantial authoritative support for an alternative treatment. A classic case of "substantial authoritative support" is in regulated industries, where the regulatory agency prescribes an accounting treatment different from that which is constituted as being "Generally Accepted" for non-regulated industries.

This exception has both advantages and disadvantages. The advantage being that specialized accounting practices may be used in special circumstances which are peculiar to the industry in question, and also provide for greater control on the part of the regulatory agency in prescribing a more uniform method of accounting procedures. This could theoretically result in greater control over varied accounting techniques, and also provide for greater consistency among the various firms representing that industry.

A disadvantage results from the lack of prompt revision of accounting standards by the regulatory agency in response to the changing economic environment of the industry in question. The economic complexities of the transportation industry require a responsive regulatory agency to modify its standards to adjust to the changing economic environment. Divergence from Generally Accepted Accounting Practices is certainly justified when real differences exist in the economic environment of the regulated and non-regulated industries. However, divergence from these standards because of lack of responsiveness of the regulatory agency is clearly not rational, and rather than providing consistency, control, and understandability of the financial data, it provides greater confusion and potential management performance impairment. The exclusion of ICC regulated companies from some of the provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940 has been examined in detail by the Staff study for the Committee on Interstate and Foreign Commerce, House of Representatives, entitled (Inadequacies of Protections for Investors in Penn Central and other ICC regulated companies) 92d Congress and the points are well made. The ICC must obtain better information about the transportation industry. Presently, the exclusion of common carriers from the provisions of the above-mentioned legislation and the lack of precise regulation by the ICC, places effective control of their financial operations and disclosure in jeopardy. Such control and responsiveness on the part of regulatory agencies is a needed and necessary prerequisite to effective regulation of these industries, and should be implemented with the recognition that deviation from the regulations of the SEC and "Generally Accepted Accounting Principles" must be for legitimate and significant differences between the nature of the regulated and non-regulated industries.

Earnings Maximization

INTRODUCTION

The earnings maximization policy of the Penn Central, and its predecessor, the Pennsylvania Railroad, has been criticized because it represented only a cosmetic improvement in the reported net income of the Railroad. It can be argued that this policy also had a detrimental effect on the cash flow of the Railroad, as well as the financial well being of the subsidiaries.

The Railroad is accused of "bleeding" dividend payments from the subsidiaries at a time when the subsidiaries could least afford to pay dividends. Most of these dividend payments were not in the form of cash, rather they were nothing more than the forgiveness of debt owed the subsidiary by the Railroad, or the incurrence of debt by the subsidiary to the Railroad.

Generally, the Railroad urged certain nonrailroad subsidiaries to use liberal accounting procedures to report as large a net income as possible. This resulted in three positive income effects for the Railroad. First, the greater the income of the subsidiaries, the greater the *consolidated* net income of the Railroad. Second, the increased income of the subsidiary allowed it to justify a higher dividend payment urged by the Railroad, even though the subsidiary might not be in a position to make a cash dividend payment. The dividends of the non-railroad subsidiaries increased the non-consolidated dividend income of the Pennsylvania Company, since this company owned most of these subsidiaries. Most of the railroad subsidiaries (excluding the Norfolk and Western RR, Wabash RR, and Detroit, Toledo and Ironton RR; the principal railroad subsidiaries owned by the Pennsylvania Company) were owned by the Penn Central Transportation Company, and their dividends increased the non-consolidated dividend income of the Transportation Company. Finally, the Railroad had Tax Allocation Agreements with certain subsidiaries. These agreements provided that each subsidiary would pay to the Transportation Company an amount equal to 95% of the income tax liability that would have been due had the subsidiary filed a separate tax return. The Railroad urged maximum profits from the subsidiaries, and then received on a consolidated income statement basis, as income, the tax payments that these subsidiaries would have had to make had they filed separate returns. The consolidated tax returns filed by the Railroad offset the profits of the subsidiaries with the huge tax losses of the Transportation Company.

It is interesting to note that the nonrailroad subsidiaries would probably not have chosen to use the accounting techniques that they did to report maximum earnings had they been independent of the Railroad's influence. The nonrailroad subsidiaries, however, never made any material cash payments under these tax agreements. Whatever cash inflow that was received by the Transportation Company came from the profitable railroad subsidiaries.

The Tax Allocation Agreements had a unique advantage to the Transportation Company. If the Penn Central desired to increase its consolidated net income by increased dividend payments from the subsidiaries, but the subsidiary was not wholly owned, the minority stockholders would similarly receive their share of the dividend distribution. The Tax Allocation Agreements however, served to increase consolidated net income without the disadvantage of a payment to minority interests. The effect of this was to conserve the liquid resources of the consolidated Penn Central by using this method of increasing net income without a distribution of cash to minority interests. Since the Transportation Company had no Federal Income Tax Liability (due to huge tax loss carry-overs), credit for the Tax Allocation Agreements served to increase consolidated net income.

IMPLICATIONS OF EARNINGS MAXIMIZATION

The policy of earnings maximization began with the Pennsylvania Railroad, probably with the beginning of Saunders' term as Chairman. This policy was carried over to the merged Penn Central, and was extensively used during the period 1968–1970. In essence, the railroad followed less conservative accounting practices than other railroads during the same period. The result of this policy was to create a wide divergence between the reported net income and the true cash flow of the company.

The main vehicles by which this policy was implemented were through transactions between the Railroad and its subsidiaries, and transactions between the subsidiaries and outside firms. The effect of these transactions was to increase the profits of the subsidiaries, thereby increasing the reported net income of the *consolidated Transportation Company*. This also increased the net income of the *non-consolidated Pennsylvania Company* by the increased dividends that the subsidiaries were able to "pay" because of their marked increase in net income. These dividends frequently did not represent an actual transfer of cash to the parent company, but frequently represented a forgiveness of a debt. Another way of reporting the dividend amounted to increasing the parent company's dividend income while increasing the debt owed by the dividend declaring company to the Railroad. The main issue here is that the profits of the subsidiaries, which showed rapid growth and implied increased dividend paying ability, were in reality "*paper profits*", contrived by the imaginative Accounting Department officials and financial managers of the Railroad.

An excellent illustration of the prevailing attitude within the Railroad concerning this policy is seen in a memo dated October 5, 1967 from W. S. Cook to Bevan concerning a pay increase for Charles Hill, Manager of General Accounting:

> . . . He has been instrumental in the progress that has been made in the accounting department within the last several years. He is extremely creative, is an excellent manager, and is very cost conscious. *His imaginative accounting is adding millions of dollars annually to our reported income.*[15] (Emphasis added.)

One of the cash effects of the earnings maximization policy was that dividends were declared by the Penn Central on the basis of reported or estimated net income, while the true amount of cash available for such dividends was not indicated by the company's inflated earnings. This situation existed for years prior to the merger, as stated in a memo to Saunders from Bevan on November 21, 1966:

> . . . Today the cash flow of the Pennsylvania Railroad is substantially less than its reported net income. We changed the basis of consolidation and, therefore, a substantial amount of earnings of subsidiaries are included in our reported net income but are not actually available to us from the standpoint of dividends. . . .
>
> Over the short term today, the New York Central earnings as reported are much more real and tangible from the standpoint of an ability to pay dividends than are those of the Pennsylvania.[16]

Bevan indicated that the subsidiaries income as reported by the PRR was not available for dividend payments because these subsidiaries had need of the funds they generated from operations to sustain their future activity. What Bevan did *not* clearly indicate was that, in some cases, the income of these subsidiaries did not represent real cash flow. That is, the subsidiaries themselves were reporting inflated or "paper profits," but were not generating a comparable cash flow from their operations.

One explanation of this policy of earnings maximization is that before the merger, the Pennsylvania Railroad needed profits to maintain the stock exchange ratio of 1.3 to 1.0. In 1962, both the Pennsylvania and the New York Central agreed to exchange 1.3 shares of the Penn Central stock for each

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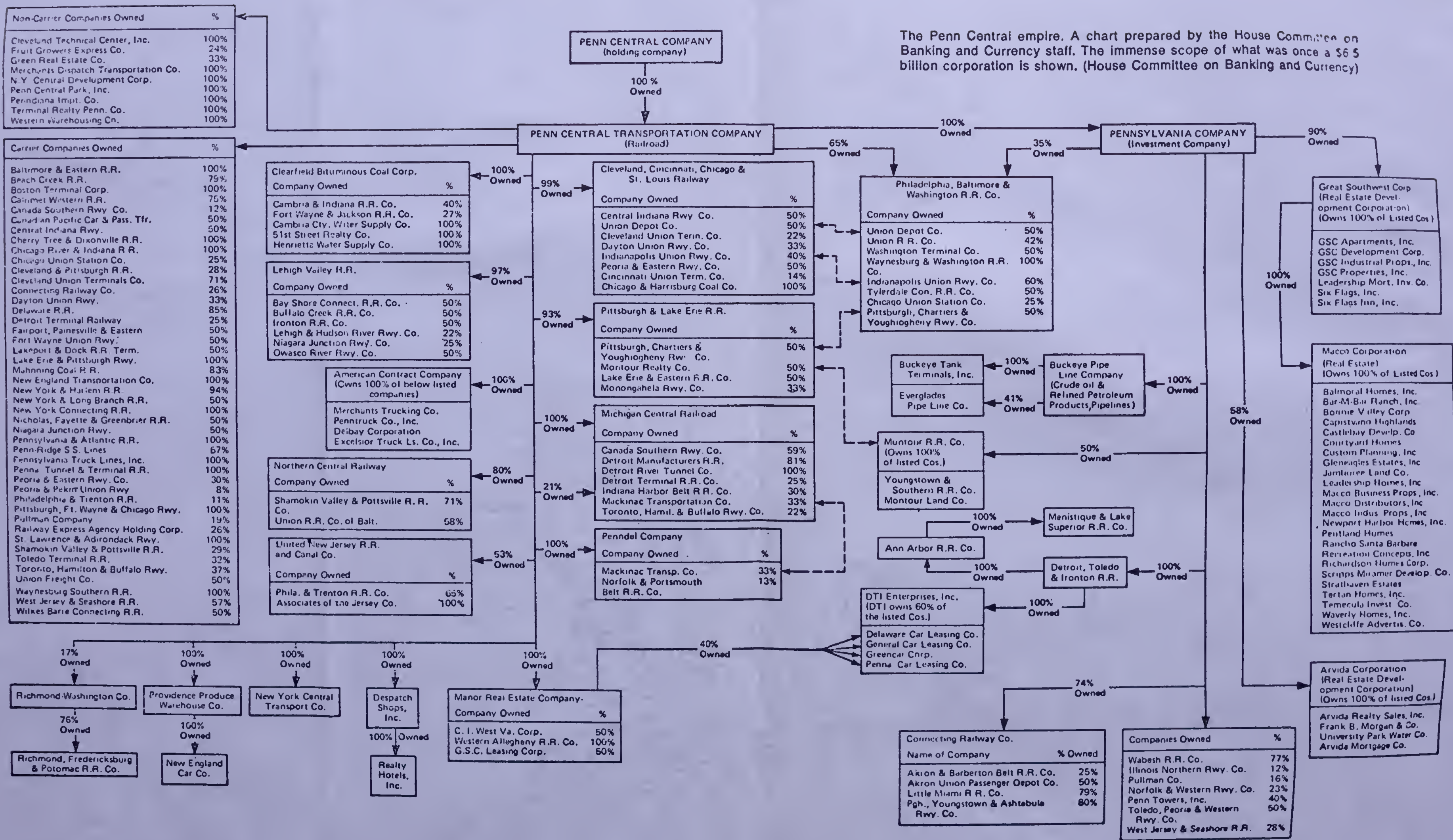
[15] Memo from W. S. Cook to D. C. Bevan, October 5, 1967; Appendix D, Exhibit 72, p. 732.

[16] Memo from D.C.B. (Bevan) to S.T.S. (Saunders), November 21, 1966, Appendix D, Exhibit 50, p. 616.

PENN CENTRAL CORPORATION

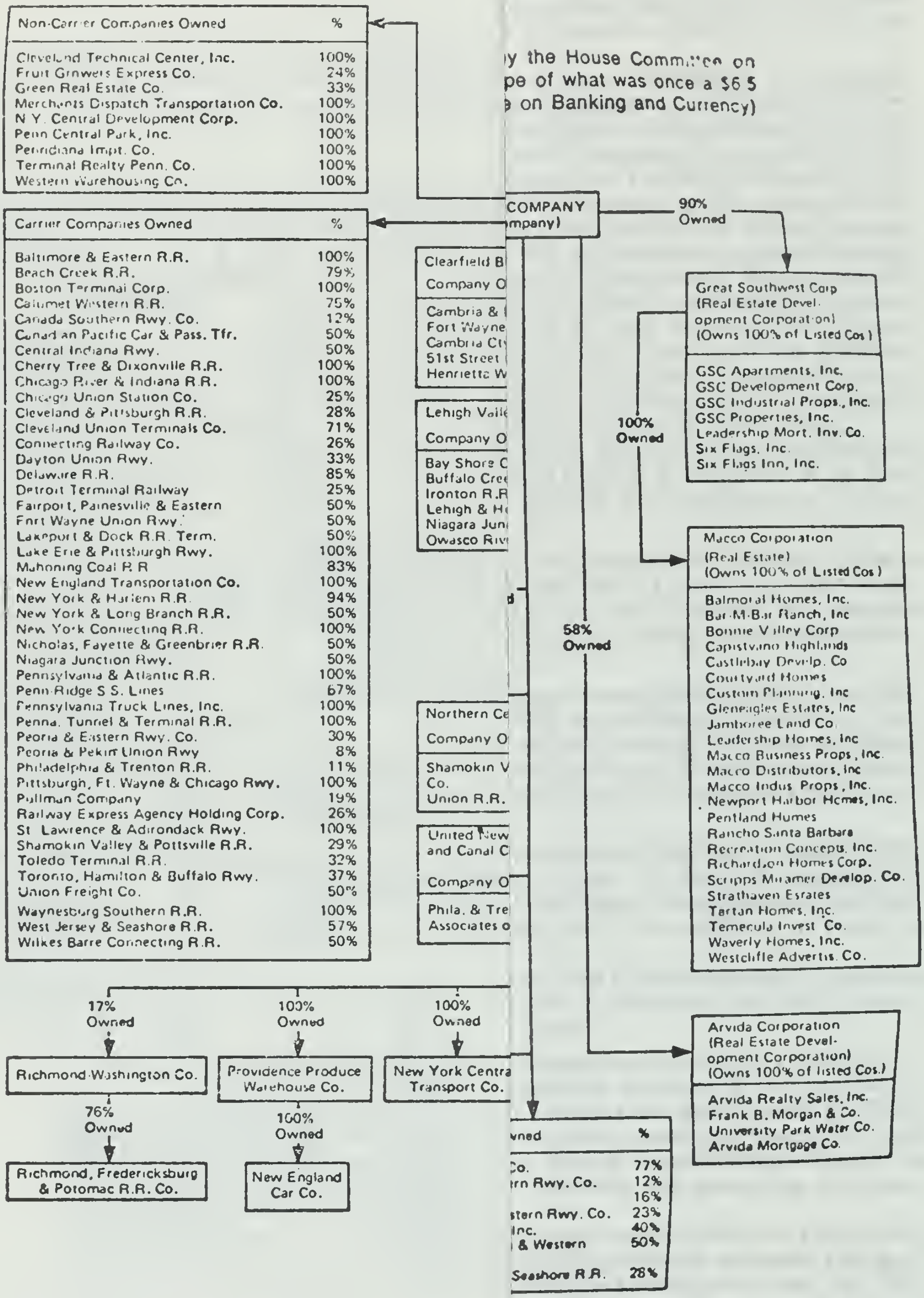
ORGANIZATION CHART (1.)

The Penn Central empire. A chart prepared by the House Committee on Banking and Currency staff. The immense scope of what was once a $6.5 billion corporation is shown. (House Committee on Banking and Currency)



Source: *The Wreck of the Penn Central*, pp. 112–113.

74-924 O - 73 (Faces p. 369) No. 2



Source: *The Wreck of the Penn Central*, pp. 112–113.

74-924 O - 73 (Faces p. 369) No. 2

share of New York Central stock, and 1.0 shares of Penn Central stock for each share of Pennsylvania Railroad stock. Thus, if the per share earnings of the Pennsylvania were much lower than 76.9% of the comparable earnings of the New York Central, there might be pressure to change the exchange ratio. Post merger, the earnings maximization policy could be justified on the basis of the Penn Central's need for external financing. If Penn Central's earnings were poor, the interest cost of debt financing might be much higher, assuming external funds would be available at all.

The increased divergence of net income and cash flow which resulted from the earnings maximization policy had serious implications for the Transportation Company. It was paying large cash dividends, following a massive capital expenditure program to modernize and improve the railroad, and diverting significant amounts of cash into non-railroad activities. Further, it was obliged to finance these programs with debt issues, since the railroad itself was not generating enough cash to fund these activities.

The diversification of the Pennsylvania Railroad, and later the Penn Central, was consummated by the Pennsylvania Company, a wholly owned subsidiary of the Railroad. Thus, when a discussion of the diversification of the company indicates that the *Railroad* invested heavily in these non-railroad subsidiaries, it is technically in error. Granted, the Railroad did invest in non-railroad subsidiaries, but the investment was either minimal, or was sold to the Pennsylvania Company shortly after the investment was made. Also, there are significant implications, resulting from the way the dividends and income from these subsidiaries were handled, which must be carefully considered before one indicates that the Railroad showed a significant improvement in its earnings because of the "paper profits" generated by these subsidiaries and the excess dividends forced by the parent company.

The Pennsylvania Company provided most of the funds that were directly invested in non-railroad subsidiaries, even though some of these funds might initially have originated from the Railroad. The investments were recorded, therefore, on the books of the Pennsylvania Company. The dividends that resulted from this diversification were income to that company, thus increasing its ability to pay dividends to the Transportation Company. On a *non-consolidated* basis, the only effect of these transactions on the Railroad was the Pennsylvania Company dividend. On a *consolidated* basis, however, the Railroad received the benefit of the higher income of the consolidated Pennsylvania Company, since these earnings are included in consolidated Railroad income.

If one remembers that the dividends paid to the Transportation Company by the Pennsylvania Company remained constant at $24 million from 1966 to 1970, it is seen that the Transportation Company's *non-consolidated* dividend income was not improved by the diversification. The only source of dividend income to the Transportation Company from the non-railroad acquisitions was the dividends of the Pennsylvania Company. *Consolidated* Railroad income was significantly improved by the inclusion of all the subsidiaries. It is this improvement that is generally referred to as the inflated earnings due to the diversification program. It is important to realize that the Railroad used these subsidiaries as a vehicle for certain earnings maximizing transactions which are discussed in another section.

Since the diversification program was carried out by the Pennsylvania Company, the accounting distinctions made concerning the way in which the dividends and earnings of the acquired companies were reported are important. These distinctions are not as significant, however, when one is concerned with the economic effect on the entire Penn Central conglomerate. The economic reality is that the funds expended by the Pennsylvania Company could have been available for use by the PCTC. The Pennsylvania Co. was regarded as a major source of financing by the Railroad, and therefore its borrowing power was, to a degree, dependent upon its earnings. The Pennsylvania Company's importance to the PCTC's financing requirements is illustrated in the minutes of a PCTC Finance Committee meeting of May 1963:

> . . . He (Bevan) stressed the importance under these conditions of maintaining liquidity and credit. Liquidity is presently provided by Nor-

folk and Western stock and this fact is recognized by financial institutions. Credit is available in the Pennsylvania Company and it is essential to continue this situation for purposes of further borrowing.[17]

Probably most significant, is the point made at this meeting with respect to earnings maximization and the investment policy of the Pennsylvania Company, which is brought out in the next section of the minutes:

> . . . A third important ingredient in the financial picture is the necessity of *replacing the income which is currently being received on the Norfolk and Western stock*. He pointed out that largely through the use of this income Pennsylvania Company has been able to bolster the financial needs of the Pennsylvania Railroad Company. . . . Total earnings for the ten year period beginning in 1953 have been $209 million, of which $198 million have been made available to this Company, either in the form of dividends or by purchase of securities. *These earnings must be maintained.*[18] (Emphasis added.)

The meeting took place on May 21, 1963, and indicates the thinking on the part of management that justifies the diversification program. The nature of these investments is discussed elsewhere, but their effect on the earnings maximization follows:

EFFECT OF EARNINGS MAXIMIZATION ON REPORTED INCOME

The Transportation Company, spending enormous sums of money for capital improvements and equipment, was confronted with an operating performance which was among the worst of any major Class I railroad. It paid regular dividends to its stockholders, even though it was losing money on its railroad operations. It tried to camouflage this reality from the financial and investing community by maximizing its earnings through a series of complicated transactions within the Penn Central Corporation, and through liberal accounting practices. The following section describes some of these transactions which occurred during 1968, 1969, and the first six months of 1970.

During 1968, the Penn Central Transportation Company reported three non-cash transactions which increased net income by $37.5 million. In December, 1968, the Transportation Company exchanged its $4.7 million investment in the Washington Terminal Real Estate Corp. and the Madison Square Garden Center, Inc. for the stock of the Madison Square Garden Corp. This transaction brought a profit to the Transportation Company of slightly less than $21 million. This was represented by the value placed on the 1,151,000 shares acquired at $11.078 per share, or approximately $25 million, less the cost of the investment traded. While PCTC reported this gain as ordinary income, such a classification seems to be in violation of the ICC accounting procedures. This was a matter of dispute between the Director of the ICC and Penn Central. Ultimately, in 1969, the Penn Central was required to change its classification and record the item as an extraordinary gain. The stockholders were advised of this reclassification in a *footnote* to the 1969 annual report.

This gain did not result in a cash inflow, but rather represented a "paper profit" on the exchange of securities. The consistency in financial reporting by Penn Central seemed to be that of valuing transactions on whatever basis that would show a profit to the Transportation Company. When PCTC sold this stock to the Pennsylvania Company in July, 1969, the selling price was PCTC's book value, even though the stock was selling on the open market at about $2.50 per share less.

The Transportation Company could not afford to record a loss on the transaction, while the Pennsylvania Company would not have to show a loss until the stock was sold. The key issue in this transaction is that a cash flow did not occur, thus income was increased by $21 million, and yet the Railroad was not in any better condition to pay the dividends that it was to declare at the end of the year. Further, the inclusion of this item in ordinary income was misleading to investors who were not informed about the nature of the transaction.

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[17] Minutes, Meeting of PRR Finance Committee, May 21, 1963; Appendix D, Exhibit 70, p. 730.
[18] Minutes, Meeting of PRR Finance Committee, May 21, 1963; Appendix D, Exhibit 70, p. 730.

In the same year, the PCTC reported a dividend declared by a subsidiary at its market value, as opposed to book value. The Penn Central and the B&O Railroad each owned 50% of the Washington Terminal Company, which owned Washington Union Station. After preliminary negotiations with the Department of the Interior concerning the proposed leasing of the station by that agency, an independent appraiser valued the property at $27,050,000. In anticipation of leasing this property to the Government, and to simplify a complicated tax situation, the Washington Terminal Company formed two subsidiaries, the Terminal Realty Penn Company, and the Terminal Realty Baltimore Company. Each of these newly formed subsidiaries received 50% ownership of the Washington Union Station, their sole assets. The Washington Terminal Company then declared a dividend of 100% of the stock of these two subsidiaries to the Penn Central and the B&O. Penn Central recorded the value of its dividend (100% of the stock of the Terminal Realty Penn Company) at the appraised market value of $13.7 million, while the B&O recorded the 100% stock dividend of the Terminal Realty Baltimore Company at its more conservative book value of $3.107 million. The appraised value of the Penn Central's dividend was later adjusted from $13.7 million to $11.7 million.

One of the major complications was that this did not represent a cash flow, but rather the valuation of an asset at an appraised value that might never be realized. Even if the lease were signed with the Department of the Interior, it would be many years before the PCTC would realize its full share of the appraised value.

The next item was the dividend declared by the Strick Holding Company to PCTC. The Holding Company was a non-operating unit whose principal assets consisted of its holdings in its two operating subsidiaries, the Strick Corp., and Transport Pool, Inc.

The Holding Company's investment in these two subsidiaries consisted of advances of $8.2 million and the book value of its investment of $2.3 million, for a total of $10.5 million. The selling price of these subsidiaries was $27.9 million; and consisted of $15 million in cash, promissory notes for $9.4 million, and the balance in warrants to purchase the stock of the firms formed to acquire these subsidiaries which were independently valued at $4.7 million.

PCTC had an investment in the holding company of $15 million in cash and advances of $9.4 million. The transaction to record the proceeds from the sale was recorded on the books of Penn Central Transportation Company, not on the books of the Strick Holding Company, i.e. PCTC received the notes and cash, and then recorded a long term liability to Strick Holding Company for this amount. The PCTC received the value of its initial investment back.

The Holding Company, however, reported a profit on the sale of these subsidiaries in the amount of $17.4 million. It is at this point that the policy of earnings maximization worked to the detriment of cash flow. By handling the transaction such that the holding company sold these subsidiaries, a significant profit was reported, which increased the tax liability of the Holding Company. While it is true that the Federal Income tax would be offset against the PCTC's tax losses, there was a Pennsylvania State tax which amounted to $787,291 which was paid by PCTC.

The profit the Holding Company reported served as the basis for the declaration of a $5.6 million dividend to the Transportation Company. It was ultimately recorded at $4.8 million, the decrease due to the tax paid by PCTC. Thus, to record a $4.8 million dividend, the Transportation Company paid more than $750,000 in taxes. Had the Transportation Company sold the Strick Holding Company instead of having the Holding Company sell its operating subsidiaries, there would have been a smaller profit on the transaction, and a much smaller tax bill from the State of Pennsylvania.

The timing of these transactions is of some importance, also. Both the Madison Square Garden stock exchange and the sale of the Strick subsidiaries occurred during December of 1968, a time when the officers of PCTC were well aware of the impending losses to be reported by the PCTC unless profits and/or dividends could be obtained from an extraordinary transaction.

During the same period, 1968, PCTC relied more heavily upon the earnings of its subsidiaries than in prior years. The effect of maximizing the earnings

of the subsidiaries was to increase the reported net income of the *consolidated* PCTC. Also, the tax allocation agreements provided income in the amount of 95% of the subsidiaries' tax liability. The Transportation Company was never to receive any cash from the non-railroad subsidiaries for the tax allocation agreements even though a receivable was set up on the books of PCTC against the subsidiaries.

The maximization of earnings of Great Southwest Corp. for example, worked to the disadvantage of that subsidiary, and to the benefit of PCTC. A September 12, 1969 letter from W. C. Baker, president of GSC, to Bevan indicated some of the disadvantages that resulted from the tax allocation agreements:

> . . . By the very nature of GSC's real estate operations, it operates in a constant tenuous cash position. This is nothing peculiar to us, but is a fact inherent in our business. Thus, the necessary effect of the tax allocation agreement is to drain resources from one of the major earnings contributors to the consolidated group; thereby hindering and restricting its ability to continue being a major contributor of such earnings. As I noted earlier, if called upon immediately to pay its full accounts payable to Penn Central, arising from the tax allocation agreements, GSC would be unable to do so, because it just does not have the cash. By the same token, we are expected to independently finance our own operations insofar as possible, but, at the same time, our ability to do so is lessened by the fact that our balance sheet must show this resulting substantial account payable to Penn Central Parent. Again, therefore, I personally question whether, in the exercise of reasonable business judgment, this is proper utilization of group financial resources.

Baker also discusses the relative disadvantages of the earnings maximization policy used by GSC at the request of Penn Central.

> . . . a disgruntled minority shareholder could nevertheless easily argue that GSC at the direct instance of the Penn Central, sold two of its substantial and profitable assets solely to produce substantial profits for the majority shareholder within given financial periods. . . . not only was GSC's income from such assets reduced, but there was no longer any depreciation whatever to offset such income; the result being that every dollar of the substantial tax savings that would otherwise be lost to the Internal Revenue Service by GSC (on a separate return basis), now amounts to a loss of $0.95 to Penn Central, at least in the form of an account payable (on a consolidated return basis), as a result of the Tax Allocation Agreement.[19]

The point to be made is that the subsidiary had front ended its profits, resulting in a higher tax liability to the PCTC because of the tax allocation agreement, and yet had no cash to pay this debt. Further, carrying the payable to Penn Central on its books made external debt financing more difficult to obtain for Great Southwest.

The degree of earnings maximization is illustrated by GSC and Macco, two real estate subsidiaries of the Pennsylvania Company. In 1968, GSC and Macco reported income of $9,654,000 and $21,021,000 respectively, for a total of $30,-675,000. Because of the nature of the sales that generated these profits, two accounting methods have applicability. The first records the entire profit in the period in which the sale is made, regardless of the amount of payment received. The second, and more conservative approach records the profit on an installment basis, the amount of profit recorded is equal to the percentage of payment received in that period. If these subsidiaries had reported these sales on an installment basis, the profits would have *decreased* from $30.7 million to $9.4 million, a $21.3 million decrease.

Another method of improving earnings involved the write-up of reuseable material removed from scrapped equipment. These materials were recorded in inventory at nominal carrying value. When these materials were renovated in

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[19] Memo from William C. Baker to David C. Bevan, September 12, 1969; Appendix D, Exhibit 51, p. 618.

the PCTC repair shops, they were increased in value in inventory to a "standard carrying value", the offset being a reduction of operating expense. If the parts were then used to repair equipment, they were expensed. However, if they were used in the rehabilitation of equipment—equipment that would either be sold, or the repair costs capitalized—the materials were written-up to 75% of replacement cost, the offset again being a credit to expense. The total write-up of inventoried material in 1968 at the Altoona repair shop alone, was as follows:

Writeup from nominal to standard	$4,938,000
Writeup from standard to 75 percent of cost	3,369,000
Total writeup	8,307,000

All of the write-up from standard to 75% of cost, and the bulk of the write-up from nominal to standard went to decrease operating expenses.[20]

During 1969, the earnings maximization policy had an even greater effect on reported income. The front-ending of profits by GSC and Macco resulted in an overstatement of their income by $30,521,032. Thus, their reported net income before tax of $51.569 million, could have been restated to $21.048 million, and the resulting tax liability would have also been reduced.

The effect of certain non-cash transactions on the reported net income of the PCTC was to increase net income by $15,326,100. This was the result of two specific transactions, the details of which follow:

The New York Central Transport Company (NYCTC) declared a $14.500,000 dividend to its parent company, the PCTC. NYCTC could only afford to pay $2.5 million in cash, and so the rest of the dividend, $12 million, was recorded as a payable of NYCTC to PCTC. But, instead of NYCTC recording the payable as "dividends payable", which is a current liability, it was recorded as a long term payable to PCTC. In this transaction, the cash actually did change hands. The $12 million that remained outstanding as a payable, actually did get paid to PCTC, and was immediately repaid to NYCTC. In fact, the transactions were almost a simultaneous transfer from NYCTC to PCTC and then back again.

The next transaction is a bit more complicated, but briefly it occurred as follows: PCTC advanced to Penntruck Co., Inc., and Merchants Trucking Co., $1.7 million and $0.3 million respectively. These subsidiaries are wholly owned by American Contract Co., a wholly owned subsidiary of PCTC. The advances were then paid to American Contract by Penntruck and Merchants Trucking. Meanwhile, Excelsior Truck Leasing paid a $1 million dividend to American Contract. Thus, the $3 million received by American Contract from its subsidiaries, $2 million of which originated with PCTC, was declared as a dividend from American Contract to PCTC. It would seem that $2 million of this had just made a circuit through two subsidiaries and was returning to the orginator, PCTC, as cash and dividend income. However, the $3 million was dividend income, but no cash was returned to PCTC. Instead American Contract used the dividend declaration to offset a debt owed to it by PCTC. The result of this was to decrease PCTC's cash by $2 million in advances to subsidiaries, while increasing its reported dividend income by $3 million.

PCTC also reported decreased maintenance expense during 1969 because of the write-up of reuseable materials, offsetting this write-up as a credit to expense.

Writeup from nominal to standard	$7,913,000
Writeup from standard to 75 percent cost	4,224,000
Total writeup	12,137,000

While not all of this write-up was offset as a credit to expense, a substantial portion of it was used to decrease expense.

For the first six months of 1970, information is not presently available concerning the maximization of the earnings of the subsidiaries. The Transportation Company accelerated the earnings it could report from extraordinary items in the first quarter of the year, in hopes that the improved earn-

[20] Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation, verified statement 36, pp. 48–9.

ings of the consolidated Penn Central would result in the successful issuance of $100 million of Pennsylvania Company debentures, the funds desperately needed by Penn Central to continue operations.

In March, 1970, PCTC sold its holdings of the Clearfield Bituminous Coal Company to the Pennsylvania Company at its equity value of $16.938 million. The book value of this investment on PCTC's books was $82,200. Thus, PCTC reported a profit of $16.856 million on the sale of these holdings.

In a direct attempt to report increased earnings in the first quarter, PCTC negotiated an agreement with Norfolk and Western to accelerate an exchange agreement in which the Pennsylvania Company's holdings of Wabash Railroad stock would be exchanged for Norfolk and Western stock. The gain on this transaction was about $50 million; it did not represent an inflow of cash to the company, and it was executed *solely* for the purpose of improving the earnings of the first quarter. Associated with this exchange, N&W demanded certain concessions, one of which was the sale of land to N&W which was owned by PCTC. The appraised value of this land was $858,600, and it was sold to N&W for $572,400, a potential cash loss of $286,200. A quarter of a million dollars was given up by PCTC in order to improve its earnings, and it did report a profit of $508,927 on the sale of the land.

In 1970, the write-up of reuseable materials in inventory increased markedly, as indicated below:

Writeup from nominal to standard	$11,584,000
Writeup from standard to 75 percent cost	658,000
Total writeup	12,242,000

The bulk of the $12.242 million was credited to expense during this period, and yet this decreased expense did not represent an inflow of cash.

To summarize the transactions described in the preceding sections, specifically their impact on earnings and cash flow, the chart below is presented.

PENN CENTRAL TRANSPORTATION CO. (COMPANY ONLY) EFFECT OF NONCASH TRANSACTIONS ON REPORTED NET INCOME

[Millions]

	1968	1969	1970
Reported net income	($2.77)	($82.81)	($102.0)
Deduct: Noncash items:			
Inventory write-up	8.00	12.00	12.00
Dividends	16.50	15.33	
Deduct: Extraordinary:			
Profits	21.00		16.86
Sale of land (profit)			.51
Conservative net income (loss) estimate	(42.73)	(110.14)	(131.37)

GENERAL COMMENTS ON EARNINGS MAXIMIZATION

There are some aspects of the earnings maximization policy that do not lend themselves to an analysis of income effect by time period. Even though the amounts of these transactions might be small in comparison with those previously discussed, the point to be made is the management philosophy which prompted handling these transactions the way they were handled.

The Railroad had a policy of using sale-leaseback arrangements wherever possible. This topic has been discussed in detail elsewhere. It is interesting to note that PCTC charged the freight costs of transporting equipment to be used in rehabilitating equipment to the sale-leaseback transactions. If the PCTC repair shops needed parts to rehabilitate the equipment for the owners, the cost of the equipment was its cost to PCTC plus a charge for transporting along PCTC lines. This resulted in additional revenue for PCTC, and for additional costs of leased equipment to PCTC. However, the increased costs of this leased equipment were paid for over the life of the lease. In essence, the Railroad received cash in the present period, but paid higher rentals for the life of the lease. Not only is this in direct violation of generally accepted accounting principles, but it is also in violation of ICC accounting regulations. These

regulations require that such charges must equal at least "50% of the reproduction cost in kind, new, exclusive of repaired material and dismantled labor cost." [21]

An ironic twist to the earnings maximization policy of the Railroad appears in employment contracts of the officers of Macco and Great Southwest. An incentive compensation agreement was signed by the Boards of Directors of these firms and the officers, which provided for a base salary and also additional compensation based on the reported net incomes of the firms. These agreements had no ceiling; the higher the profits, the higher the income for the officers. The irony is that after these contracts were signed these subsidiaries were urged to maximize their profits to improve the consolidated earnings of the Transportation Company. The additional compensation paid as a result was a significant sum of money.

The employment contracts (as amended in 1968), provided that the following compensation shall be paid to the officers:

Officer	Position	Base salary	Incentive (percent) [1]
Wynne, A. G	Chairman	$25,000	3
Baker, W. C	President	60,000	2
Ray, W. D	Executive vice president	35,000	1
Caldwell, H. L	do	55,000	1

[1] Incentive compensation was based on net reported income in excess of $10,000,000 in any fiscal year. Thus, Wynne received 3 percent of the net income in excess of $10 million, Baker 2 percent, and Caldwell and Ray 1 percent each.

Additional provisions in these five year contracts called for a severance pay of $3 million to Wynne, $2 million to Baker, and $1 million each to Ray and Caldwell, should any of them have their employment terminated by the Company. The result of these agreements in cash paid by Macco and GSC are as follows:

	Wynne	Baker	Ray	Caldwell
December 1968	$200,000	$130,000	$70,000	$30,000
June 1969	99,000	69,000	29,000	69,000
Settlements				
July 1969	1,000,000			
August 1969	2,000,000			
December 1969	125,000	100,000	40,000	
January 1970			35,000	55,000
Total	3,124,000	299,000	174,000	154,000

Thus, $3,751,000 was paid to these officers as a part of their employment contracts. The payments listed under "settlements" above, are due to the cancellation of the old employment contracts, and the renegotiation of new contracts. There is some question that the settlements provided for in these contracts were not legally binding on the Company, since there was a clause in each of them providing that the contracts could be terminated at will by the Company.

The point is that Saunders, Gerstnecker, and Bevan, all members of the Board of Directors of GSC, signed the minutes of the June, 1968 Board of Directors meeting indicating that they had read the individual contracts and gave their approval. Bevan sent a copy of the minutes to Saunders, who was not at the meeting, and received his signature on October 23, 1968. Bevan indicated that the contracts were similar to other contracts within the industry, and with the contracts that were approved several years before when PCTC first acquired control of Macco. The approval from Saunders in October validated the contracts, each of which was dated June, 1968.

Less than 7 months later, Bevan had Saunders sign a memo to the effect that these contracts would be terminated, and the settlement penalties would

[21] Id. at p. 50. The amount of these freight charges during the 1968–1970 period was $2,457 million.

be paid to the officers. Saunders indicated that he understood that the settlements were "the best that can be made under the circumstances".[22] There was no serious attempt made to verify the legality of the contracts or the settlements. The settlements imply that the earnings of Macco (in 1969 Macco merged with GSC) would be $35 million, and do not take into consideration discounting the settlement payments.[23]

It seems that Bevan was a supporter of these contracts, and indicated to Saunders that these contracts were reasonable and characteristic of those within the real estate industry. Although this is speculation, it seems incongruous that any financial officer as experienced as Bevan would be ignorant of the nature of these contracts. That is, that the salaries of the officers had no ceiling, and that the earnings of the Company were highly variable depending upon which accounting treatment was used. Thus, Bevan might have advocated the contracts as incentive to the officers to use liberal accounting practices to deliberately "front-end" profits; thereby furthering both their interests and the earnings maximization needs of the Penn Central Transportation Co.

The Transportation Company engaged in other policies and practices which depressed current expenses in an effort to improve the reported net income of the Railroad during the post-merger period. Unfortunately, data does not appear to be available to indicate the dollar magnitude of such practices, although there are indications which lead one to believe that the amounts of money are significant.

One of the more interesting practices was that of capitalizing repairs to rolling stock. While ICC accounting regulations specifically proscribe the capitalization of repairs of owned equipment, the Railroad would sell the equipment to "straw parties", repair or rehabilitate the equipment for the new owners in the Railroad's repair shops, and then lease back the repaired rolling stock from its new owners.

The effect of this procedure was to decrease the amount of maintenance expense, provide cash to the Railroad for general corporate use, remove the sold equipment from the provisions of the general mortgage bonds under which it was originally financed thus allowing it to be used as collateral for funds to finance the repairs, and provide increased lease payments in future periods to cover the cost of overstated repair estimates for this equipment.

One procedure by which the sale-leaseback arrangements were consummated was an initial sale to a "straw party" of used rolling stock or equipment. The Railroad would then negotiate an agreement with the new owners to repair the equipment for an estimated amount of money. The new owners would then negotiate sale agreements between themselves and a subsidiary of the Railroad. The subsidiary would then lease the property to the Railroad, and assign the lease to a bank or other financial institution.[24] The fee of the "straw party" was the equivalent of the amount of the investment credit.

This was done for several obvious reasons. As mentioned above, the sale of the equipment removed it from the provisions of the general mortgage bonds of the Transportation Company. It then became available as collateral to finance the renovation. The expense of the renovation was not charged against income, but rather was capitalized on the books of the new owners. Finally, the financing obtained from the banks to pay for the renovation was based on the estimated costs of such renovation. The Railroad consistently overstated these cost estimates, thus the difference between the actual costs and the funds available from financing was then made available for general corporate use. This meant that the increased repair costs were paid over the life of the lease, but the Railroads present need of cash for survival was a much more immediate concern than the increased lease payments in the future.

Another way the Railroad decreased current expense was the liberal use of the merger impairment reserve to charge off the labor costs the Railroad felt was due to a labor protection agreement. This agreement was signed by

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[22] Memo from S. T. Saunders to D. C. Bevan, June 2, 1969; Appendix D, Exhibit 73, p. 733.

[23] Wayne's $3 million settlement, for example, was equal to incentive compensation of $75,000 per year, based on profits of $35 million. Had the payments been discounted at 8 percent for example, over the remaining 4 years of the contract, Wynne's payments would have been $2.205 million. The premise that the earnings would have been $35 millon for the next 4 years is very questionable.

[24] Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation, Verified Statement 36, p. 47.

Saunders and Perlman on May 20, 1964, and required that in the event of merger, to take into the merged company all PRR–NYC employees:

> who are willing to accept employment and that none of the present employees of either applicants shall be deprived of employment or placed in a worse position with respect to compensation, working conditions, fringe benefits or rights and privileges pertaining thereto at any time during employment.[25]

A major problem here was that the agreement was one of a kind, and accurate estimates of the costs of some of the provisions were not available. One of the worst aspects of this agreement was the delay in consummating the merger. The three year delay meant that any furloughed employee must be given a job by the merged Railroad. The costs of this were readily determinable by December of 1967. The total labor cost estimate of the agreement, initially proposed at $78.2 million over eight years would now cost $195.2 million. The increased $117 million was the estimated cost of the recalled labor.

Provisions for this cost were included in the Merger Impairment Reserve, set up by the Railroad in 1967 in the amount of $275.4 million. The total amount paid in connection with the labor protection provisions was $54.4 million not including $5 million in relocation expenses. In 1968, $22.460 million was charged against this reserve, and in 1969 $12.604 million was charged against the reserve. While conceptually the Railroad and the ICC agreed that these costs would not have been incurred had there been no agreement, the use of the impairment reserve to charge employee's wages when the employees were working opened the door to disagreement concerning how the account should be handled. The Railroad was charging the wages of operating employees against this account, if the employee had been recalled as part of the labor protection provisions. Although the propriety of these charges has been strongly defended by the PCTC, there are questions about how an employee's time can be charged to a reserve account if that employee is engaged in productive labor. The Railroad's position was that these employees were operating at far less than a standard level of efficiency established by the Railroad. The exact amount of charges to this reserve, which applied to recalled labor in 1968 and 1969, amounted to $14.842 million and $8.126 million respectively. The total amount of $22.968 million eludes analysis of what should have been charged to operating expense, and what was a reasonable allocation to the merger impairment reserve account.[26]

CONCLUSION

One of the most important questions concerning the Penn Central debacle centers on the effects of the earnings maximization policy and the degree to which this policy contributed to the ultimate financial collapse of the Transportation Company.

While an obvious effect of the policy was to improve the earnings of the Transportation Company by profits on inter-company transactions and large non-cash dividend payments extracted from the subsidiaries, the result of this was to conceal the true crisis that the Railroad faced, e.g. constant operating losses and a poor (and frequently negative) cash flow from ordinary operations.

In the sense that this is considered from an investors viewpoint, they were certainly misled by the devious machinations which produced a significantly inflated net income figure. The financial community was also led to believe that the Railroad was performing better than it really was.

On a consolidated basis, with most of the intercompany profits and dividends eliminated, the Penn Central still benefited from the "front-ended" profits of some of the real estate subsidiaries. The point is that the profits were significantly improved on both a consolidated and non-consolidated basis, and this improvement was deceptive to the investing community.

While this approach may be rationalized on a pre-merger basis as an attempt to preserve the long agreed to exchange ratios; and on a post-merger

[25] Penn Central Merger, 327 ICC at 684.
[26] See Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation. Verified Statement 11, Exhibit NPE 8; Reproduced in Appendix D, Exhibit 74, p. 733.

basis as a means of providing a profit picture which would facilitate financing arrangements, it is still a rationalization.

There is another aspect of earnings maximization that is quite significant: What was the effect of this policy on the subsidiaries? While not all subsidiaries were "bled" of dividends and "forced" to maximize earnings, those that were affected by the Railroad's policy were damaged because of it.

Subsidiaries were forced to provide financing for their own operations to the greatest extent possible, and yet had to pay taxes to the Railroad instead of the Government. GSC and Macco are prime examples of companies that had a potential of future growth, and suffered serious liquidity problems, directly because of the policies and requirements urged upon them during the period when the Transportation Company exerted strong influence over their operations. In a sense, the Railroad drained every dollar of profit from them that it could, without providing anything to them in return.

Probably the most vexing question concerning the earnings maximization policy is the extent that the Railroad suffered from budget cuts and decreases in maintenance expenditures in a desperate attempt to show a profit. The reason this is the most difficult question is that the Railroad had been unprofitable, so how could additional (and excessive) maintenance and capital expenditures be justified? It was a vicious circle. The Railroad could not make a profit because of poor service, partly due to poorly maintained facilities and equipment. But when vast sums were spent on capital improvements, the Railroad could not generate any return on the investment. How could Bevan justify borrowing funds at 8–10% and not receive any return on the funds borrowed? Obviously Bevan felt that the way to maintain the Penn Central as a viable operation was to offset the unprofitable Railroad with the profits of the subsidiaries.

The earnings maximization, to the extent that it deceived the investing public, drained the resources of its subsidiaries, deferred maintenance and capital expenditures, and sought to improve profits at the expense of losing cash, certainly postponed the seemingly inevitable reorganization, but at a great cost to everything that came under its influence.

Dividend Policy

The dividend policy of the PRR and later the PCTC has been criticized because of the excessive payouts relative to both reported net income and cash provided by operations. It might be that the Board of Directors simply was not aware of the financial situation of the Railroad or acted solely upon information presented by the Finance Committee (discussed subsequently), or there was a conflict of interest between the members of the Board's personal interests and their responsibility to the Penn Central.

Before the merger, it may be argued that the dividend payout of the PRR was influenced to a strong degree by the merger agreement signed in 1962. From 1964 to 1967, the dividend payout per share for the NYC and PRR approximated the 1.3 to 1 stock exchange agreement. That is, the NYC dividend was close to 1.3 times the PRR dividend. The dividend payout ratios and the ratio of PRR dividends to NYC dividends appear below:

PENN CENTRAL TRANSPORTATION CO. DIVIDEND PAYOUT RATIO[1] 1963–69

[Percent]

Year	PRR	NYC	PCTC	Class I	Class I (adjusted)[2]
1963	73.75	46.47	61.89	58	[2] 58
1964	58.96	43.62	51.58	65	67
1965	81.60	43.69	60.18	58	58
1966	70.99	43.23	56.37	55	55
1967	237.70	1,747.58	359.21	167	157
1968			(3)	91	81
1969			(3)	105	81

[1] Computation: dividend paid/net income after tax.
[2] Restated to eliminate PRR and NYC dividend payouts.
[3] Negative ratio: 1968, $55,400,000/–$2,800,000; 1969, $43,400,000/–$82,800,000.

Source: Moody's.

While the 1963–1966 dividends payouts are not significantly different from those of all Class I railroads, the PRR paid a much higher dividend relative to net income than the NYC. When this is coupled with the acute cash shortages that plagued the railroad, it is difficult to justify the dividends paid by the PRR as being anything but excessive. Even so, the fact that dividends had been paid consecutively since 1848 was a strong factor in maintaining a dividend payment. Breaking a record of consecutive payments of over 115 years might not have been justified, but the magnitude of the dividends paid is inexcusable.

The computations presented in the preceding table are for the Transportation Company only, not for the Penn Central System. While it can be said that this is not a valid comparison, it is illustrative of the payout ratios from the most significant aspect of the Penn Central System in terms of income generating power available for dividend payouts. That is, the income generated on a consolidated basis was not available for dividends since the subsidiaries had their own needs for the funds that they generated from their operations.

A major question of responsibility for the dividend payouts leads to a presentation of how the dividends were approved. Usually the Finance Committee of Penn Central met to evaluate the earnings and proposed dividends: from this evaluation came a recommendation to the Board of Directors for their consideration. The Finance Committee's minutes for May 13, 1969 read as follows:

> The Chairman of the Board reviewed briefly estimated earnings on a consolidated basis for the second quarter of the year. He reported also on the steps taken to improve the earnings of the railroad.
>
> Whereupon the Committee, on motion, approved a recommendation to the Board that it declare a regular quarterly dividend of 60 cents a share.[27]

Present at the meeting were Bevan (Chairman of the Committee), Saunders and Perlman, among others. The presentation of the results of the meeting to the Board of directors was made by Saunders:

> At this time we will take up the matter of the second quarter dividend.
>
> Our earnings projections for the second quarter are inconclusive at this time. We estimate, however, that our consolidated earnings will be around $20 million.
>
> Our preliminary figures show that while it is still an uphill fight, we are making real progress in bringing the Railroad into the black.
>
> * * * * * * *
>
> While, as I have said, it is much too early to know exactly where we will come out, I think that the prospects are very good to equal or better the results in the Second Quarter of last year.
>
> Recommendation: In light of the results to date and the prospects for the remaining weeks of the quarter, the Finance Committee recommends the payment of the regular quarterly dividend of 60 cents per share . . .[28]

In a Board meeting of June 25, 1969 a discussion of the proposed third quarter dividend was as follows:

> As we discussed at the meeting of the Finance Committee and Executive Committee on June 13, preliminary estimates . . . are about the same as last year . . . on a consolidated basis.

After discussing some possibly negative aspects of the economy, i.e. high costs of money, governmental anti-inflationary policy, and a long coal miners holiday, Saunders proceeded:

> Despite these unsettled conditions, the Finance Committee, after consideration of all the factors, recommends the payment of the regular dividend of 60 cents per share . . .[29]

The information presented to the Board of Directors is certainly not a true picture of the real performance of the Railroad, and makes no mention of the

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[27] Minutes. Meeting of PC Finance Committee, May 13, 1969; Appendix D, Exhibit 75, p. 735.
[28] Board Memorandum, May 13, 1969; Appendix D, Exhibit 76, p. 735.
[29] Board Memorandum, June 25, 1969; Appendix D, Exhibit 77, p. 737.

perilous cash position of the Railroad. While some directors resigned from the Board because of information not presented to them in the Board of Directors meetings, and later discovered through the news media, most of the Board complacently authorized dividend payments without knowing the true difficulties of the Transportation Company itself. Possibly Saunders' credibility and political skills let the Board lapse into a state of accepting whatever was presented.

PENN CENTRAL CO. STOCK OWNERSHIP AND STOCK REPRESENTED BY DIRECTORS AT DECEMBER 31, 1968 MEETING

Name	Position with Penn Central	Nature of stock interest	Number of shares	Personal gain	Gain by representation
Bevan, D.	Chairman of finance committee	Personal	34,107	$81,856	
Saunders, S.	Chairman of the board	do	45,987	110,368	
Seabrook, J.	Director	do	5,850	14,040	
		International Utilities Corp	500,000		$1,200,000
Graham, R. Jr.	do	Personal	84,000	201,600	
		Wife	2,610	6,264	
Kirby, F.	do	Coguardian for Allan Kirby, Sr.	390,130	936,312	
		Alleghany Corp	196,195		470,868
		Investors International Diversified Services, Inc.	1,020,000		2,448,000
Totals			2,278,879	1,350,440	4,118,868

Source: ICC Docket No. 35291. Penn Central Investigation, V.S. 8, pp. 19–20.

One cannot help but wonder what motivated Bevan and Saunders to minimize the true performance of the railroad and its cash position at those meetings where dividends were declared. Saunders, as it turns out, held every share of stock until after the reorganization, but Bevan sold 25,000 of his shares between January 1, 1969 and June 24, 1970. Bevan knew of the precarious position of the Railroad and benefited from the sale of his stock, while the reports issued by Penn Central indicated that the Transportation Company had problems, but the non-rail subsidiaries were more than adequate to compensate for the poor position of the Railroad. Is it not realistic to assume that Bevan, who had been with the Railroad since 1954, and was hoping for the chairman's position when Symes retired, was quite disturbed when Saunders was appointed in his place. It seems that the pattern for this assumption is evidenced by the encouragement of dividends, his "private" investment club, Penphil, and his selling of the bulk of the Penn Central stock, when published reports indicated that the Company's performance was improving.

In any event, the dividends placed a considerable cash drain on the Railroad that could not be paid from the Railroad's profits. In fact the Railroad had to borrow money to finance such dividend payments. The imputed interest costs of the dividends declared by the Penn Central is as follows:

PENN CENTRAL

COMPUTATION OF INTEREST COST RELATIVE TO MONEY BORROWED TO REPLACE MONEY EXPENDED THROUGH DIVIDEND PAYMENTS, 1963 TO JUNE 1970

[Thousands omitted]

Year	Dividends paid	Cumulative value	Interest rate (percent)	Year	Imputed interest cost
1963	$10,026.9	$10,026.9	4.63	1964	$0.464
1964	28,974.6	39,001.5	4.67	1965	1.821
1965	45,386.9	84,388.4	5.71	1966	4.819
1966	53,646.7	138,035.1	6.25	1967	8.627
1967	55,051.9	193,087.0	7.76	1968	14.984
1968	55,400.3	248,287.3	9.00	1969	22.384
1969	43,396.2	291,883.5	10.00	[1] 1970	14.594
Total					67.673

[1] Through the 1st 6 months of 1970.

Source: ICC Docket No. 35291, Penn Central Investigation, V.S. 4, Exhibit DD7; Reproduced in Appendix D, Exhibit 78 p.743.

Internal Control After Merger

INTRODUCTION

The internal controls present in the merged Penn Central give an indication of the effectiveness with which pre-merger planning was implemented. The cash shortages which constantly plagued the Railroad originated long before the merger took place. One would think that timely and accurate reports of cash balances and outstanding receivables would have been the subject of considerable attention during the initial phases of the merged Railroad's operations. In fact, after the merger, cash balances were not reconciled promptly, nor were receivables properly controlled. The write-off of estimated bad debt expense soared after the merger. The internal controls of the Railroad were either nonexistent or had seriously deteriorated. While operating and accounting officials might have been aware of this situation, the correction of these deficiencies never became a reality.

Bevan had operated for years with severe cash shortages, but the cash drains of the merged Railroad created a liquidity crisis that even he had not experienced before. Bevan had indicated that the minimum cash required for the Pennsylvania Railroad to operate and still maintain adequate cash compensating balances required by certain loan agreements was $45 million to $50 million.[30] The merged railroads set $100 million as an acceptable cash balance. At the date of the merger, February 1, 1968, the cash balances of the railroads were $5.5 million and $7.8 million for the PRR and NYC, respectively. The $86.3 million shortage from the ideal cash balance suggested by Bevan, was complicated by the cash losses incurred after the merger.

Initially, Bevan had been in charge of the Accounting Department of the Pennsylvania Railroad; but upon merging, this function was given to Perlman, the President of PCTC. Even when this department was restored to Bevan's control in 1969, there was no improvement in the amount of receivables outstanding, nor was there an improvement in the timeliness and accuracy of the reconciliation of the cash accounts. The following sections give an indication of the effect of the breakdown in internal control on the operations of the Railroad, and the increased interest expense and borrowings necessitated by this breakdown.

INTERNAL CONTROL

Both the PRR and NYC had been moving toward a centralized billing and collection system prior to the merger. The PRR had progressed further in this centralization than the NYC. After the merger, the PRR's basic system was modified into a system of seven Customer Accounting Centers. These centers were responsible for checking and revising weights, preparing freight bills covering inbound carload freight, collecting charges from credit patrons, maintaining agency accounts to insure the collection of cash items by agency forces, and checking and revising rates and charges.

The employees at these centers would perform the above functions, and then code the bills for key-punching. The data was then transferred to a master accounts receivable tape. Inexperienced personnel, understaffed and overworked departments, and the resultant backlog of waybills to be processed resulted in a breakdown of the accounts receivable system.

The effective operation of this system depended upon the accuracy and timeliness of the processed information. Peat, Marwick, and Mitchell (PMM), in a December 22, 1969 letter to C. S. Hill, pointed out that inaccurate ratings of waybills produced an excessive volume of disputed bills, each requiring the individual attention of an already overworked staff.[31] The PMM study found

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[30] Memo to Saunders from Bevan, November 8, 1967; Appendix D, Exhibit 36, p. 558.

[31] Letter and report to C. S. Hill from Peat, Marwick, Mitchell & Co., December 22, 1969; see Appendix D, Exhibit 66, p. 705.

that there were no incentives offered by the Railroad to attract and keep the experienced and qualified personnel required to verify and revise the rates on waybills.

Perhaps the greatest concern in this area of control should have been the management of accounts receivable. The processing of payments took so long, that frequently customers received several notices requesting payment for bills which had been paid long before. It was quite common for customers to refuse to pay bills promptly, if at all, because of poor service or lost shipments. Many customers returned bills amounting to thousands of dollars, when only a small amount of the bill was in dispute.

The internal procedures in the Centers were not set up to handle the large volume of disputed customer's bills. When a partial payment was made, the system made the application to the customer's account a difficult procedure. This resulted in the item being charged to a fictitious account "Paul P.", which served as a clearing account for unidentified and partial payments. The head clerk was to reconcile this account, clearing it out and correctly applying the payment to the customer's account. Since the original entry to the "Paul P." account did not update the customer's master file, and the time taken to clear this account was so long, the customer would receive another bill for the entire amount.

The Accounting Department lacked a mechanized way of processing the volume of disputed and partially paid bills, leading PMM to recommend that such a system be implemented. The breakdown in control was not due to the incompatibility of the different computers used by the PRR and NYC, both before and after the merger, since there was little need for the interchange of data between the two computers in the accounting function.[32] The problem centered upon the great amount of manual handling and analysis of transactions.

The loss of control of receivables had a negative cash impact on the Railroad. The PCTC had a self-imposed target on the collection of receivables. A negative cash effect was due to receivables over 30 days old. that were in excess of 12.8% of total receivables. The results of the cash impact of the failure of the Transportation Company to meet its target are found in Table AR–1.

TABLE AR–1.—PENN CENTRAL TRANSPORTATION CO. ACCOUNTS RECEIVABLE OUTSTANDING OVER 30 DAYS—CASH IMPACT POSTMERGER

[Dollar amounts in thousands]

Date	Amount unsettled	Delinquent (over 12.8 percent)	Interest rate [1] (percent)	Interest expense [2]
January 1968	$51,688.1	$9,277.5	7.25	$297.7
June 1968	57,645.3	7,148.0	7.25	384.0
January 1969 [3]	72,316.4	14,040.6	8.25	721.3
June 1969	86,987.4	20,933.1	9.75	1,088.1
January 1970	86,529.4	23,707.9	9.75	554.2
March 1970	100,547.9	21,763.7	10.00	509.3
Total				3,554.6

[1] Source: ICC Docket No. 35291, Penn Central Investigation, V.S. 4, Exhibit DD–7 modified byschedule AR–1; reproduced in Appendix D, Exhibit 78, p. 743.

[2] Interest expense computed on the average amount delinquent for each period. Taken as an average of: $(\text{Delinquent}_n+\text{delinquent}_{n+1})$ 2×i rate/2.

NOTE: This assumes that funds were borrowed to provide the funds for operations which could have been generated had the 12.8, percent target been met.

Source: ICC Docket No. 35291, V. S. 31, pp. 1-9.

The interest expense and the amount of additional funds which would have had to have been borrowed to replace the funds tied up in excessive receivables is determined by the following table:

[32] See Interstate Commerce Commission, Docket No. 35291, Penn Central Investigation, Verified Statement 32, pp. 7–11.

TABLE AR-2.—PENN CENTRAL TRANSPORTATION CO. EFFECT OF ACCOUNTS RECEIVABLE ON INTEREST EXPENSE AND BORROWINGS

[In thousands of dollars]

Year	Interest expense	Additional borrowings [1]	Cumulative borrowings
1968	681.7	8,212.8	8,212.8
1969	1,809.4	9,274.1	17,486.9
1970 (6 months)	1,063.5	5,248.9	22,735.8
Total	3,554.6	[2] 22,735.8	

[1] Additional borrowings are required only to the extent of the average accounts receivable increase between periods.
[2] This total represents the average accounts receivable (over 12.8 percent) for the first 6 months of 1970.

Source: Chart AR-1, schedule AR-1.

The purpose of this analysis was to illustrate the extent to which the Transportation Company had to borrow funds that would normally have been available had the accounts receivable system been designed and managed properly. Thus, management's abdication of effective control of accounts receivable cost the Railroad $3.5546 million in additional interest costs and required them to borrow additional funds, indicated by Tables AR-1 and AR-2, to fund its excessive receivables.

While it is true that in a period of rising interest rates, and a general shortage of funds available on the open market, the collection of accounts receivable will become increasingly more difficult, the rate of increase in these balances of PCTC was far greater than those of all Class I railroads.

It is interesting to note that PCTC's management spoke of estimated balances in accounts receivable, as opposed to specific amounts. In an undated memo (about December, 1969), Basil Cole stated:

> The accounts receivable balance is now $75 million which is $15 million *higher than it was assumed to be in October.* (Emphasis added.)

Considering the magnitude of the balances, it is hard to believe a 25% increase in accounts receivable in two months, especially when the amount is $15 million can be treated as casually as Cole did in the next sentence:

> . . . *This does not represent a loss of position as much as it does identifying more accurately the scope of the problem.*[33] (Emphasis added.)

It would seem that an increase of this magnitude would represent a loss in position, and would require immediate attention. In the same memo, he disclosed the results of a special study undertaken to determine the best areas in which to concentrate to speed collection. The results are as follows:

PENN CENTRAL TRANSPORTATION CO., ANALYSIS OF DELINQUENT ACCOUNTS AT DECEMBER 1969 (OVER 10 DAYS OLD)

Amount outstanding	Number of firms whose debts total this amount	Average
$2,000,000	2	$1,000,000
$3,000,000	5	600,000
$4,000,000	8	500,000
$5,000,000	15	333,333
$6,000,000	23	260,870
$7,000,000	35	200,000
$8,000,000	50	160,000
$9,000,000	88	102,273
$10,000,000	161	62,112

Cole indicated that the larger offenders were withholding payments until claims against the Railroad were resolved. He felt that when the offenders were identified, officers within PCTC should be requested to contact them for payment. It seems that Cole minimized the *cause* of the build-up by

[33] Memo from Basil Cole (no date) ; see Appendix D. Exhibit 79, p. 745.

suggesting that the *effect* (excessive receivables) be resolved. Further, he chose accounts that were only 10 days old. In a study made in April 1970, an analysis of billing and collection lags yielded the following:

PENN CENTRAL TRANSPORTATION CO.

AN ANALYSIS OF BILLING AND COLLECTION LAGS, APRIL 1970

Lag	Inbound freight (days)	Outbound freight (days)
Billing (processing)	7.61	6.33
Mail lag (PCTC to customer and customer to bank)	5.47	5.32
Customer payment	9.18	7.22
Total lag	22.26	18.87

In each case, the customer billing lag is less than the processing lag of the Transportation Company. Even though the payment lag is greater than that allowed by ICC regulation, it certainly doesn't seem excessive, especially considering the quality of PCTC's billing system. Cole expects his customers to perform significantly better at paying than the Railroad was at billing.

While inaccuracy in billing, double billings after payment, and rapidly deteriorating quality of service affected the Railroad, as discussed above, it also alienated customers and caused a marked increase in estimated bad debts expense. This is dramatically illustrated when a comparison of the combined estimated bad debts expense is compared with sales volume:

PENN CENTRAL TRANSPORTATION CO.[1]

AN ANALYSIS OF BAD DEBTS EXPENSE AS A PERCENT OF SALES

Year	Estimated amount uncollectible (thousands)	Percent change in writeoff [2]	Percent o revenues
1965	$2,805.5	100.00	0.1805
1966	2,748.4	97.96	.1742
1967	2,728.4	97.25	.1807
1968	14,446.4	514.93	.9528
1969	22,720.6	809.86	1.3754

[1] Prior to 1968, data is for combined NYC and P.RR.
[2] Percent change: 1965 equals 100 percent.

Source: Schedule AR-2.

The absolute and percent changes in the write-off is less significant if there had been a marked change in revenue levels (which had not happened), but the percent of bad debts expense to revenues is quite significant. Pre-merger, the average write-off as a percentage of sales was .1785%; post-merger, the average write-off was almost 1% of total revenues. The increase in the write-off as a percent of revenues was 762%. This certainly indicates that management had lost control of collection of its receivables. Equally important, it indicates that the quality of service had deteriorated drastically after the merger, assuming one can conclude that the degree of bad debt expense write-off is highly correlated with the quality of the service performed. While none of the conclusions drawn from this data is new, it certainly corroborates already stated hypotheses about the service and management control of the post-merger Railroad.

A second general area of a breakdown in control was in the preparation of bank reconciliations. Not only was there no standard form on which these reconciliations were made (the format varied from month to month, making interperiod comparisons difficult), but Peat, Marwick, Mitchell & Co. reported to Saunders:

> Bank account reconciliations are not prepared promptly by the Treasurer's office at the close of the accounting month. Delays as long as three to five months occurred in the preparation of such reconciliations. . . . Obviously, failure to reconcile promptly bank accounts and outstanding

checks and drafts causes a serious breakdown in the maintenance of an effective system of internal control.[34]

A result of the lack of internal control with respect to these reconciliations was that when the accounts were finally reconciled, a massive accumulation of unidentified adjustments had to be written off. While the trustees of PCTC could not indicate the magnitude of the prior period write-offs, they identified $797,075 of unreconciled bank charges and $430,309 of unreconciled credits on December 31, 1970.

In essence, the lack of control certainly worked against effective cash management. Accurate and timely reports of cash balances were not available; and yet this was the most pervasive problem faced by the Transportation Company, a chronic shortage of cash. In this situation, having a control on the exact amount of cash available is essential, not only for the obvious reason of minimizing borrowing, but also to prevent the misappropriation of funds.

An excellent example of the loss of cash was the appropriation of $4 million by Fidel Goetz in 1969. Goetz established the First Financial Trust of Liechtenstein, a shell corporation organized to be the depository of $10 million of PCTC funds to be used for the repair of rolling stock. The $10 million was a loan arranged through a consortium of German banks, and was deposited with First Financial on September 18, 1969. The same day, Goetz transferred $4 million to Vileda Anstalt, another shell corporation controlled by him. Goetz felt that he was entitled to the funds because of losses he suffered in connection with his participation in Executive Jet Aviation's financing, another subsidiary of the Transportation Company. PCTC believed that the funds were still on deposit with First Financial, and accordingly reported it under "Capital and Other Reserve Funds" on their 1969 report to the ICC. The loss of the funds was not discovered until after the bankruptcy. Although the $4 million loss was quite extraordinary, it should have been discovered had effective control existed within PCTC.

While internal control problems, losses, and the additional expenses resulting therefrom did not make enough of a difference to have prevented the collapse of the Railroad, it was symptomatic of the general operational and managerial environment.

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[34] Letter from Peat, Marwick, Mitchell & Co. (Henry A. Quinn) to Stuart T. Saunders, June 3, 1969; See Appendix D, Exhibit 80, p. 746.

DIVERSIFICATION

The diversification program of the Penn Central Railroad was principally that of the Pennsylvania Railroad to which the Penn Central Transportation Co. had fallen heir. More precisely the program was largely carried out by Pennsylvania Company, a subsidiary of the Pennsylvania Railroad and subsequently a subsidiary of Penn Central Transportation Company. Pursuant to a decision made earlier, the Pennsylvania's diversification program essentially began in June of 1964 with the acquisition of controlling interest in Great Southwest Corp. and 100 percent of the outstanding stock of Buckeye Pipe Line Co. a month later. A little over a year later the Pennsylvania made two other acquisitions, the Arvida Corp. in July, 1965 and Macco Realty Corp. in August, 1965.[1] A major investment, principally in debt securities, was also made beginning in late 1964, in Executive Jet Aviation, Inc.

The New York Central (NYC or Central), on the other hand, made only one major non-rail acquisition during the 1960–1967 period preceding the Penn Central merger. This was of Strick Holding Co. in November, 1966. Unlike the Pennsylvania Railroad (PRR or Pennsylvania), no formal diversification program was devised at the Central and little or no effort seems to have been made in seeking additional acquisition possibilities. Moreover, unlike the acquisitions of the PRR, which were of businesses engaged in operations entirely independent of those of the parent company, Strick's activities, that of manufacturing light-weight trailers and containerized equipment used in the railroad industry—both of which had been utilized in the Central's Fexi-Van operations since 1956—bore a relationship to the operations of the railroad.

The PCTC, while announcing plans for a major diversification effort itself soon after the consummation of the merger,[2] and although attempting to acquire Kayser-Roth, a major apparel manufacturer, in 1968,[3] nonetheless completed only one acquisition before bankruptcy, that of Southwestern Oil Refining Co. and its subsidiary, Royal Petroleum Corp., in February, 1970.

Moreover, this transaction was later rescinded pursuant to an agreement and court order dated April 4, 1971.[4]

In connection with the following discussion several tables have been prepared in order to present the several effects (financial and otherwise) of the diversification efforts. These include (1) total amount of purchase funds committed (including types of consideration utilized); and other funds committed to the program in the form of (2) interest and dividends paid out on debt/equity securities used in the purchase price of the acquired companies and (3) loans and advances by the railroad and its subsidiaries to the non-rail subsidiaries after acquisition. The magnitude of these investments will also be

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[1] Initial efforts at diversification were actually begun as early as 1960, not so much at that time because of the desire on the part of the railroad to diversify (although admittedly this was a factor), as it was an attempt to find a means by which the railroad could more effectively utilize its existing properties, and, more specifically, its rights-of-way. A group called the "Committee on Potential Pipelines in the PRR System," which included Charles J. Hodge, Chairman of the Executive Committee of the investment banking firm of Glore Forgan, Wm. R. Staats and Co., and a firm of engineering consultants, Pipe Line Technologists, Inc., submitted as early as July 28, 1960, a specific recommendation for the PRR to acquire Buckeye, Appendix D, Exhibit 1, p. 493.

[2] Associated Press article May 14, 1968, in which Stuart T. Saunders announced plans for a $500 million diversification effort by the railroad into "companies with imaginative management with the promise of expanding profits." Appendix D, Exhibit 2, p. 494.

[3] Preliminary agreement for the acquisition of Kayser-Roth, the nation's largest apparel manufacturer, by the PCTC (to have been accomplished through the Pennsylvania Co.) was announced June 26, 1968. Terms called for the issuance of two series of Pa. Co. preferred stock with a total value of approximately $230.7 million. After approval by the board of directors of both companies (and a later revision which was also approved), but before submission to the shareholders of the companies for their affirmative vote, the transaction was terminated on November 6, 1968—ostensibly because the two firms were "unable to agree upon final detailed terms." (Even here, however, the initial acquisition of Kayser-Roth stock had been begun by the PRR through its Pension Fund in mid-December of 1967.)

[4] See judgment in Civil Action 70-C-135 (*Former Shareholders of Southwest Oil Refining Co. and Royal Petroleum Co. versus Penn Central Co.*), U.S. Federal District Court (S.D. Tex., Corpus Christi Div.).

compared to funds being reinvested in the railroad itself—in terms of total capital and maintenance expenditures, and an examination made of the source of funds for each. Other tables will among other things measure the return which the railroad received on its non-rail investments in the form of (1) reported earnings (including the effects on the parent railroad's consolidated statement) and (2) actual cash return (including dividends, interest and tax allocation payments) with respect to total cash investment (including loans and advances).

The discussion of the diversification program and its effect on the PCTC and its predecessors will be divided into four parts: (1) an analysis of the program itself—including its *raison d'être* (stated or implied), its magnitude, how financed, and investment pattern (stated or implied); (2) the financial effects of the program (as determined by the operating performances of the acquired companies post-acquisition) measured in (a) absolute terms (reported income and total cash returns) and (b) relative terms (to railroad investment [total capital and maintenance expenditures] and to pro-forma railroad income—less income from non-rail acquisitions); (3) an evaluation of diversification itself as a policy, including an examination of its application in the PCTC (and/or its predecessors') case in terms of its effect on, e.g., the railroad's cash position and otherwise, and the role, or lack thereof, that the ICC has played in this area; and (4) conclusions and recommendations including an assessment of the weight (relative and absolute) that should be given to diversification as a factor leading to the bankruptcy of the railroad.

Diversification Programs

PENNSYLVANIA RAILROAD

Although the Pennsylvania Railroad possessed substantial real estate holdings in major cities in the geographical area which it served (e.g., New York, Chicago, Newark, Detroit, Pittsburgh and Philadelphia), the vast majority of these holdings prior to 1964 had been acquired incident to the rail operations of the company and had been developed in an effort to seek additional revenues from the existing physical plant.[5] Unquestionably these combined non-rail activities did contribute substantially through, for example, rental and capital gain income to the consolidated earnings of the railroad and cannot be ignored. The effect of income from these sources on the total earnings of the company will be examined later in this discussion. However, a specific diversification program in the usual meaning of that term was not begun until late 1962-early 1963.[6]

The Pennsylvania then owned about 2.4 million shares of Norfolk and Western Railway Co. common stock—which it had purchased beginning in the early 1900's—with a total market value of approximately $300 million. Realizing that ownership of this large block of stock, which had given the Pennsylvania effective control of the Norfolk and Western, might well have posed a competitive barrier to the proposed NYC–PRR merger pending before the Interstate Commerce Commission, David C. Bevan, then Vice-President Finance, of the Pennsylvania, in his August 1962 testimony before the ICC in connection with the merger, had discussed the possible disposition of these shares. Faced with the situation that the PRR in all probability would have to sell its N&W holdings, which had produced a substantial dividend income which the company had used to supplement its other earnings, the railroad was confronted with the decision as to what should be done with the proceeds of such sale.

In consideration of this problem, a memorandum, dated April 30, 1963, was prepared by Bevan setting forth a full discussion of the issue including analysis of the alternative uses of such funds which could have been employed

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[5] Because of the fact that ownership of such holdings was held in many subsidiaries, most of which were rail or rail-related operations, it would be nearly impossible at this date to segregate amounts expended on rail and non-rail activities in order to determine what the magnitude of total funds expended on the combined real estate holdings was, on either an annual or cumulative basis.

[6] Diversification is here defined as the calculated acquisition of companies engaged in operations in product markets, unrelated to that of the acquiring company, ostensibly, e.g., for reasons of attaining economic stability, increasing earnings, etc.

by the railroad. Because the document's conclusions express the management philosophy adopted by the Pennsylvania,[7] the text is inserted herein in its entirety:

[MEMORANDUM BY DAVID C. BEVAN, APRIL 30, 1963]

The holdings of the Pennsylvania Railroad System of the Norfolk & Western Common are listed below showing the amounts held in each company, the cost and market values, as well as the number of shares pledged:

	Shares				
	Free	Pledged	Total	Cost	Market Value
Owned by:					
Pa. Co	645, 540	1, 711, 343	2, 356, 883	$60, 847, 706	$284, 004, 402
P.R.R	40, 401		40, 401	2, 139, 611	4, 868, 321
Total	685, 941	1, 711, 343	2, 397, 284	62, 987, 317	288, 872, 723

Some time ago, on the recommendation of the Financial Department, the board approved, in principle, of disposing of our Norfolk & Western Preferred stock and a portion of this has been liquidated and the balance will be as soon as we can get a proper price for our stock. Until now, however, no action has been taken with respect to the possibility of disposing of any or all of our common stock. Although personally I believe the market price of the common should tend to move upward over the next several years, no one can be sure that this will be the case, and purely from a standpoint of market value conservatism would indicate that it would be well to start a gradual liquidation of our holdings. However, at this time, of course, it is still not possible actually to predict whether or not our merger will be approved. Therefore, it would seem wise that we retain at least a portion of this stock to maintain a strong strategic position in the merger picture in the event our merger application is disapproved. Just how much this should be, of course, is a matter of judgment, but in my opinion it should represent a minimum of 15% of the voting power of the Norfolk & Western in the event their merger is approved and ours is not, or in other words, 1,550,000 shares. (This is based on the proposed capitalization of the Norfolk & Western rather than that now outstanding.) In the event that a policy of liquidation up to the amount indicated is agreed upon, the question naturally arises as to how it would be accomplished, the timing, and, of course, of great importance the utilization of the proceeds. In analyzing this situation, it should be pointed out that at the present time there are only 40,401 shares of common stock held by the Pennsylvania Railroad with the balance in the Pennsylvania Company. Over a period of time we have been transferring the Norfolk & Western common to Pennsylvania Company as it had cash with which to purchase the stock and as the cash was needed by the Pennsylvania Railroad. This procedure was followed rather than that of declaring excessive cash dividends to the Pennsylvania Railroad. As a result, the record shows that a sound and conservative dividend policy has been followed by Pennsylvania Company and its assets have gradually been increased through the purchase of Norfollk & Western stock with a corresponding improvement, of course, in its earnings position as well. If the Financial world or the public were to think that the Pennsylvania Railroad manipulated the company to satisfy its own requirements and needs without regard to maintaining the financial stability of the Pennsylvania Company, the latter's credit could be irreparably damaged overnight.

At first we had in mind the necessity of maintaining and improving Pennsylvania Company's credit to facilitate the refunding operation which took place in 1960. As the railroad industry's credit picture continues to deteriorate generally and as the earnings situation of the Pennsylvania Railroad does likewise, it has become increasingly doubtful that we will be able to carry out refunding operations in 1965 and 1968 on the basis originally planned. This problem has been further accentuated by the necessity for going to the market for $50 million of financing this year. In other words, it is now entirely possible that we will have to use Pennsylvania Company as a vehicle for further financing in 1965 and 1968. In order to be able to accomplish this, we must continue to manage the affairs of this company on a conservative basis both as to dividends and the maintenance of its assets.

Although this was not the case originally, in the past 4 or 5 years, in our opinion, the banks who are making our standby credit available to us have looked more and more to the assets of the Pennsylvania Company to justify the credit rather than to the credit of the Pennsylvania Railroad itself. It was probably for this reason that in 1958 the banks changed the standby agreement to provide that specifically the Pennsylvania Company stock could not be pledged for any other purpose. Therefore, it seems apparent that maintenance of the credit of the Pennsylvania Company is not only necessary from the standpoint of possible refunding operations in 1965 and 1968, but also for the maintenance of our standby credit with the banks.

[7] On October 1, 1963, Stuart T. Saunders, the former President of the N&W Railway Co. became the new Chairman of the Board of the PRR. Saunders quickly dispelled any thoughts as to what course the railroad would pursue in regard to a diversification program. At a news conference held on November 7, 1963, soon after assuming office at the Pennsylvania, he reported that the railroad was actively considering a variety of diversification proposals. Although not being more explicit than indicating that some acquisitions might lie outside transportation, he noted at the time that the railroad would have a "new look." (Philadelphia *Bulletin*, November 7, 1963) ; Appendix D, Exhibit 3, p. 494.

With the foregoing in mind, we can therefore analyze the various possibilities which are available for the utilization of the proceeds of the sale of any of the Norfolk & Western common stock.

1—It has been suggested that we might buy in the debt of the Pennsylvania Railroad thus reducing our obligations and our interest charges. On the surface this would appear to represent a conservative course, but on analysis, it would be unattractive and undesirable for several reasons. If the available cash is either paid out in dividends to the Pennsylvania Railroad or advanced to the Pennsylvania Railroad by Pennsylvania Company, the credit of the latter will be injured, and in our judgment, it will be likewise impaired if Pennsylvania Railroad debt is purchased by Pennsylvania Company rather than Pennsylvania Railroad. This would follow because Pennsylvania Company credit would become increasingly dependent on the success of Pennsylvania Railroad. Furthermore, as a practical matter it is not possible to buy in very much railroad debt at current prices. We know this from experience. We have a very difficult time buying our 4½s of 1965, our 5s of 1968 and it is all we can do to get sufficient bonds to meet the sinking fund requirements on the 3⅛s of 1985. However, even if this were possible, as a practical matter this would mean permanently investing our money on about a 6% basis before taxes and 2.9% after taxes. It may be said that we are not in taxes at the present time but certainly no one contemplates that we will not be sometime in the not too distant future, and as indicated, this represents a permanent investment on this basis and to the extent that it is done, the liquidity of the System has likewise been reduced.

2.—It has also been suggested that the money be invested in projects showing an overall saving of 25% or more in the Pennsylvania Railroad. Here again we have the same problem as in the case of buying in the bonds. As funds are transferred to the Pennsylvania Railroad, the assets are reduced correspondingly in Pennsylvania Company and its earnings decreased. However, in addition this means reducing the liquidity of the system and putting more funds into fixed property. In the post-war period, we have invested approximately $100 million annually in capital expenditures in the Pennsylvania Railroad. Much of this has been in projects theoretically yielding savings. However, as the records indicate, we have not realized the savings or they have been taken away from us in one way or another. There is nothing to indicate that there is any change in this situation at the present time and if this is true, then the acquiring of additional funds from the Pennsylvania Company for this purpose cannot be justified. However, if for some reason these savings can be realized in the future, and there is nothing to indicate they can, the amount we are spending on capital projects based on capital expenditures savings should be such to rather quickly put us back on a profitable basis and then an increasing amount can be put into such projects. In brief, if the savings can be brought down to net in the future, then there is no need of acquiring these funds from Pennsylvania Company and if not, there is no justification from a stockholder's point of view for doing it.

It seems fairly clear that proceeds realized from the sale of the Norfolk & Western stock can best be justified for the acquisition of other equities the income from which, when we get into taxes, will only be taxable on a 7.8% basis. Furthermore, this should be done with an eye to capital gains which will be involved upon the sale of Norfolk & Western stock. Assuming liquidation ultimately of all of Norfolk & Western common stock, based on present market values the capital gain involved will approximate $220 million exclusive of the Norfolk & Western stock which we may or may not get for our Wabash holdings. Assuming that we use all of our loss carry forward to offset these capital gains, there would still be a capital gains tax of approximately $32 million. This would also be a very extravagant use of our loss carry forward since if it were used instead as an offset to net income, the savings would be 52% instead of 25%. At the present time we also have flexibility in that in any year we see we are going to lose a portion of this tax carry forward loss at that point we, of course, could sell Norfolk & Western stock and utilize the loss carry forward. If the common stock is sold gradually, we should be able to find sufficient capital losses to offset capital gains. For example, we still have a substantial amount of Lehigh Valley stock involving a substantial potential capital loss if a way to sell it can be devised. Mr. Warner and I believe that if we do receive a divestiture order from the ICC that it may be possible to obtain specific legislation to minimize the capital gains problem. Legislation of this character was passed in 1942 at the time there was a forced liquidation of utility holding companies and more recent specific legislation was passed to minimize the tax problems in the duPont divestiture of General Motors stock.

Finally, it should be pointed out that at the present time we have only in round figures 686,000 shares of Norfolk & Western stock that is not pledged so that this is the maximum amount that now could be included in any liquidation program. Further, if it is desired to go ahead with the one investment project that we have in mind at the present time, based on present market values, it would require the proceeds from the sale of almost 550,000 shares of Norfolk & Western stock to enable us to acquire 80% of the company in question.

There are some legal and technical problems involved which, depending on the amounts and manner of disposition, will tend to complicate this situation to some extent.

Summarizing, it would appear that a conservative course would indicate the liquidation of approximately 850,000 shares of Norfolk & Western stock as this amount becomes free. This should be done gradually so that we can avoid a capital gains tax and so that we will have sufficient time to plan an intelligent program for the reinvestment of the proceeds in other common stocks of a quality which will allow us to maintain the credit standing of the Pennsylvania Company so that it can be used as a vehicle for refunding operations in 1965 and 1968, if this is necessary, and so that it will continue to be a credit cornerstone for our standby agreement with the banks. Through the proper selection of companies in which we can invest the proceeds, this should assure an enhancement of the value of the Pennsylvania Railroad stock over a period of time.

Also it should be borne in mind that over a year ago we outlined a long range program for the utilization of Pennsylvania Company as a holding company, which we believe is completely compatible with everything said in the foregoing paragraphs.

(The fact that the N&W holdings did not in fact provide the expected funds to finance the resulting acquisition activities of the Pennsylvania will be discussed at a later point in this analysis.)[8]

In addition to the stated rationale that diversification was being undertaken in order to most effectively utilize the proceeds from the expected sale of the company's N&W stock interests, there were also other implied reasons underlying such action, paramount of which was a serious concern over rail operations earnings and the prospect for their ever achieving an adequate return. The Bevan memorandum [above] itself makes quite clear that the chief financial officer of the railroad believed that any amount of investment in the railroad would not result in savings sufficient enough, even on a sustained cumulative basis, to put the railroad in the black—pointing to the $100 million in capital expenditures made annually by the railroad in the "post-war" (presumably WW II) period which had either not realized the savings anticipated, or if so, had been taken away from the company "in one way or another." [9] Such a philosophy, when taken in conjunction with the urgency and vital manner in which the merger with the NYC was viewed by the PRR, demonstrates the rather clearly held belief of the top management of the Pennsylvania that the company was on a liquidation course unless an acceptable means of subsidizing the failing rail operations could be found. Diversification into non-rail business operations with a better rate of return was viewed (along with the expected savings from the proposed merger) as a principal means of accomplishing this result.[10]

Another implied rationale for adoption of a diversification program related to the above improved rate of return argument was the attempt by the railroad to enhance the value of its stock by achieving a higher reported consolidated income figure. This demonstration of the company's concern for the interest of the shareholder is also evident from the following excerpts from the Bevan memorandum, *supra* (as well as from the approval of such a course of action by the Chairman of the Board and its adoption by the company's Board of Directors):

* * * In brief, if the [rail operation projects] savings can be brought down to net in the future, there is no need of acquiring these funds from Pennsylvania Company and *if not, there is not justification from a stockholder's point of view for doing it.*

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[8] A secondary reason for entering into a program of diversification (in connection with its more practical objective of buying earnings) was the desire on the part of the railroad to utilize its large unused tax carry-forwards. More specifically, assuming that 80% of a company could be acquired by the railroad, permitting the consolidation of its financial operating results with those of the parent company, earnings of the acquired company could be as much as doubled (assuming an approximate 50 percent corporate tax rate) by utilization of the railroad's unused tax loss carry-forwards. Continued losses from rail operations could also be offset against earnings from the non-rail acquisitions. In addition, a railroad financial department memorandum dated May 10, 1963, prepared in connection with the Buckeye Pipe Line Co. acquisition noted that the railroad had not "claimed all permissible deductions and thus there were options available with respect to additional deductions which we [the railroad] can exercise when our earnings position so warrants." Appendix D, Exhibit 4, p. 494.

[9] "It has also been suggested that the money be invested in projects showing an overall saving of 25% or more in the Pennsylvania Railroad. Here again we have the same problem as in the case of buying the bonds. As funds are transferred to the Pennsylvania Railroad the assets are reduced correspondingly in Pennsylvania Company and its earnings decreased. However, in addition this means reducing the liquidity of the system and putting more funds into fixed property. In the post-war period, we have invested approximately $100 million annually in capital expenditures in the Pennsylvania Railroad. Much of this has been in projects theoretically yielding savings. However, as the records indicate, we have not realized the savings or they have been taken away from us in one way or another. There is nothing to indicate that there is any change in this situation at the present time and if this is true, then the acquiring of additional funds from the Pennsylvania Company for this purpose cannot be justified. However, if for some reason these savings can be realized in the future, and there is nothing to indicate they can, the amount we are spending on capital projects based on capital expenditures savings should be such to rather quickly put us back on a profitable basis and then an increasing amount can be put into such projects. In brief, if the savings can be brought down to net in the future, then there is no need of acquiring these funds from Pennsylvania Company and if not, there is no justification from a stockholder's point of view for doing it." Memorandum dated April 30, 1963, by David C. Bevan in text, *supra*.

[10] It was also necessary that any reinvested proceeds from the sale of N&W stock realize an extraordinary high rate of return merely to replace the income which the stock had provided to the railroad. This was true because of the highly favorable corporate tax treatment afforded dividend income received from other domestic corporations. In the Bevan memorandum, *supra*, it is stated "At 1962 levels, our N&W holdings provide annual income of almost $13.5 million and the stock which we would receive in connection with the Wabash transaction would increase this annual income to almost $17 million. Although this dividend income is not now subject to any Federal income tax because of our current lack of taxable earnings, it is important to remember that a substantial difference exists tax-wise between dividend income and other types of income." Under existing federal corporate income tax regulations, only 15% of such corporate domestic dividends are taxable as ordinary income to a shareholder corporation. The remaining 85 percent of any such dividend is excluded. (Internal Revenue Code of 1954, Section 243[a].)

* * * Through the proper selection of companies in which we can invest the proceeds *this should assure an enhancement of the value of the Pennsylvania Railroad stock over a period of time.* [Emphasis suplied.]

NEW YORK CENTRAL

Although the New York Central also possessed extensive real estate holdings [11] which contributed heavily to consolidated earnings (and, more specifically, which had for several years been depended upon to offset unfavorable results from rail operations), no independent effort to diversify was undertaken until the railroad acquired the Strick Corporation in November, 1966.[12]

No stated rationale for the acquisition was to be found in connection with the transaction other than that contained in an ex-post facto reference in the company's 1966 Annual Report wherein it was remarked: "This investment was made to achieve further diversification [in addition to the real estate activities described in footnote 11 above] with the potential for a good rate of return on our investment." [13] Acquisition of Strick was thus not reflective of a major change in management policy but was more an ad hoc supplement to the company's rail operations. No formal analysis procedures for appraising potential acquisition candidates were apparently ever established.

PENN CENTRAL TRANSPORTATION CO.

The merged company was thus the heir to the above-described diversification activities of its predecessors. However, despite the fact that only one nonrail acquisition was accomplished during the little more than two years of its existence (and that was eventually rescinded), the PCTC had nonetheless formulated its own diversification program. As has been mentioned above, on May 14, 1968, just three and a half months after merger, S. T. Saunders announced that the new company would diversify by spending approximately $500 million in a variety of fields over the following six years. Moreover, as it had been five years earlier with the PRR, the stated rationale was that the company was seeking to replace its 1,700,000 shares of N&W stock holdings with "investments that would become additional sources of growth and [have] stability of earnings." [14] (Quite obviously disposition of these holdings had been much slower than originally anticipated.)

More specifically, the objectives of the program were set forth in a memorandum used by Saunders in connection with the presentation of the proposed Kayser-Roth acquisition to the PCTC Board of Directors in June, 1968:

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[11] Like the PRR, the Central's real estate holdings had also been developed incidentally to the company's rail operations. Held through various subsidiaries, the most valuable of these were situated in New York City along and over what had formerly been the open cut which the railroad had used for its tracks leading to and from its Grand Central Terminal in mid-Manhattan. It was on the viaducts constructed over these tracks and alongside of them that the railroad, beginning in the early 1900's built office buildings and hotels stretching from 42nd Street to 50th Street and from Lexington Avenue to Madison Avenue. Some 22 major office buildings are situated on this 29 acres of land. In addition the Central owned Realty Hotels, Inc., which owns and operates four hotels—the Biltmore, Barclay, Commodore and Roosevelt. The Central also owned the Waldorf-Astoria Hotel, which is leased to an outside operator. Moreover, the NYC also held large tracts of land on Manhattan's West Side, and in the Bronx, in New York City, as well as in the Great Lakes and mid-West regions.

Other non-rail operations owned (but not acquired during this period) by the Central included the Clearfield Bituminous Coal Corporation, engaged primarily in the business of owning and developing coal mines.

For reasons expressed earlier in connection with the non-rail operations of the PRR, it would be impractical (if not impossible in the NYC case because of a lack of records—as well as the mixture of corporate activities in the several subsidiaries) to determine what magnitude of funds was expended by the railroad on its non-rail activities. However, the importance of total non-rail income contribution in comparison to that from the railroad has been extracted and will be set forth later in this chapter.

[12] Acquisition was actually of the parent Strick Holding Co., of which Strick Corp. and World Investments, Inc. (which owned a trailer rental company and the sales and service subsidiaries) were the principal operating subsidiaries. Although no other non-rail acquisitions were actually consummated by the NYC during this period (1/1/60 through 1/31/68) records of the company do reveal that diversification for the railroad was discussed as early as 1963 when the company considered the possibility of using railway rights-of-way as a water distribution network, and, more specifically, considered the acquisition of the Ohio Water Service Co.—a firm engaged in the distribution and sale of water in Ohio. (See letter dated 11/8/63 from J. J. Wright to J. O. Boisi, Vice President Real Estate, NYC and letter dated 10/8/65 from J. J. Wright to A. E. Perlman, Appendix D, Exhibits 5 and 6, pp. 503, 506.) Consideration of this acquisition appears never to have gone beyond the preliminary analysis state.

[13] NYC 1966 Annual Report at p. 19.

[14] Associated Press article dated 5/14/68; Appendix D, Exhibit 2, p. 494.

Before going into the details of the plan, I would like to mention some of the fundamental objectives of our diversification program which have served as guideposts in investigating the merits of this particular investment. First, of course, are the minimum requirements of profit, growth potential and beneficial use of our tax shelter.

Next, we feel that a company must be sufficiently large and established as a going concern to insure perpetuation and growth with existing management. In other words, we are seeking to become investors in profitable firms, not managers. Transportation companies and basic industries which are large users of railroad service are not prime candidates because of potential conflict with certain anti-trust theories and regulatory policies of the ICC. In addition, we have no desire, indeed cannot, compete with some of our best customers.

Another objective is to coordinate our diversification program with the requirement that we divest ourselves of our N&W holdings within the next seven years. This accomplishes two results in one transaction. It also improves acceptability of the diversification in the eyes of the Government, at whose insistence the divestiture is taking place. Moreover, there are the obvious advantages in using securities, rather than cash, in a transaction of this size.

Another requirement is to make the acquisition in a clear-cut, business-like way, in order to eliminate the prospects of proxy fights and price competition.[15]

The unstated reasons for a continued pursuit of acquisition activities remained, however, the same—the need for additional earnings to offset the continued losses from rail operations.[16]

TIMING

The timing of the PRR's acquisition program was ostensibly planned to coincide with the expected divestiture of its N&W stock holdings.[17] However, the adoption of a diversification program at that time seems to have been also prompted by a concern over dwindling non-rail income (from a high of $37,894,000 in 1958 to a low, excluding income from acquired subsidiaries of $13,534,000 in 1966)—which had been providing the consolidated earnings for the railroad. The latter concern was, moreover, in addition to the larger problem confronting the railroad of how to combate its failing rail operations. The timing in regard to the specific acquisitions made by the PRR was, of course, dependent upon their availability for purchase.

The NYC's sole acquisition of Strick Corp. appears to have had little, if any, planning in regard to its timing. Its availability, the Central's familiarity with its operations and the fact that it was an opportunity to further add to its non-rail earnings appear to have made this acquisition, as stated, an ad hoc situation.

The PCTC's diversification program was essentially a continuation of that of the PRR and was undertaken for the same basic reason: the need to supplement the continued rail losses. The timing of actual investments undertaken was again on an availability basis.

MAGNITUDE

The combined purchase commitment by the PRR, NYC and PCTC (including the type of consideration utilized) to diversification is set forth in the following table:

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[15] Appendix D, Exhibit 7 at p. 507 for full text.

[16] The concern for such an effect is evident from a reading of a memorandum dated 8/14/68 from S. T. Saunders to D. C. Bevan wherein it is stated: 'What is your schedule for submitting the Kayser-Roth proxy material to the SEC and filing the ICC application? It would be helpful to be in a position to include the income in our third quarter earnings." (Appendix, Exhibit 8,.) See also a similar memorandum dated 5/28/68 from D. C. Bevan to S. T. Saunders, wherein it is stated that Kayser-Roth ". . . would add substantially to our earnings, and continue to do so in the future and should have a favorable effect on the market value of our stock." Appendix D, Exhibit 9, p. 508.

[17] Such divestiture was later required by the Interstate Commerce Commission on June 24, 1964, as part of the conditions imposed in connection with its approval of the N&W s merger with the Nickel Plate and the Wabash. (See report and order of the same date in Finance Docket No. 21510, etc., *Norfolk and Western Railway Co. and New York, Chicago and St. Louis Railroad Co.—Merger*, etc., 324 I.C.C. 1 (1964). These conditions included the requirements that the PRR and Pennsylvania Co. (1) place all voting rights in N&W common and preferred stock owned by them under three separate voting trust agreements, with the agreements and trustees of each to be approved by the Commission; (2) divest themselves of all ownership in N&W common and preferred stock within a ten year period ending October 15, 1974; and (3) divest themselves of all ownership in Wabash preferred stock within the same ten year period. In addition the PRR and N&W common stock held by Pennsylvania Co. will he exchanged, over the period of ten years, for N&W's 4⅝%, 15 year subordinated convertible debentures in a total principal amount of $104,000,000.

INVESTMENTS BY RAILROAD AND RAILROAD SUBSIDIARIES (AND/OR PREDECESSOR COMPANIES) IN SELECTED NONRAIL BUSINESSES (JAN. 1, 1960 TO DEC. 31, 1970)

[Dollar amounts in millions]

Company making acquisition, date	Company acquired	Type of interest	Consideration (in millions)
Pennsylvania Co., Jan. 1, 1963 to June 24, 1964	Great Southwest Corp	50 percent (voting stock)	[2] 13.246
Pennsylvania Co., June 24, 1964 to Dec. 31, 1969	do	32 percent (voting stock)	[2] 38.58
Total		82 percent (voting stock)	[2] 51.826
Pennsylvania Co., July 26, 1965 to Dec. 31, 1966	Arvida Corp	51 percent (stock)	[3] 18.335
	do	7 percent	[2] 3.711
Total		58 percent	[2] 22.046
Pennsylvania Co., July 24, 1964	Buckeye Pipe Line	100 percent (stock)	[4] 100.293
Pennsylvania Co., 1963	Long Island Pipeline Co. (later merged into Buckeye Pipe Line Nov. 15, 1966.	50 percent (stock)	[2] .203
		Debt	[2] 6.797
Total			[2] 7.000
Pennsylvania Co., Aug. 13, 1965 to Dec 31, 1965.	Macco Realty Co. (later merged into Great Southwest Corp., Feb. 26, 1969).	99.9 percent (common and 6 percent cum. pfd. stock).	[2] 39.451
New York Central RR. Co., Nov. 1, 1966 to Feb. 1, 1968.	Strick Holding Co. (including Strick Corp. and World Investments, Inc.).	100 percent (stock)	[2] 15.000
Penn Central Transportation Co., Feb. 1, 1968 to Dec. 31, 1969.		Loans	[2] 6.337
			21.337
Do		do	[2] 3.100
			24.437
American Contract Co. (P.R.R.), Nov. 4, 1964 to Dec. 31, 1967.	Executive Jet Aviation	Long term notes	[2] 13.865
		57 percent Class B non-voting common.	[2] .345
American Contract Co., and Pennsylvania Co., Jan. 1, 1968 to Dec. 31, 1969.	Executive Jet Aviation	Advances (short term notes).	[2] 7.155
Total			[2] 21.365
Pennsylvania Co. & Penn Central Transportation Co. (joint ownership), December 1968 to Dec. 31, 1969.	Madison Square Garden Corp	23 percent (common stock)	[5] 27.697
Penn Central Co., February 1970	Southwestern Oil & Refining Co. (including wholly-owned subsidiary, Royal Petroleum Corp.). [6]	100 percent (stock)	21.083
		100 percent (stock)	5.115
			[7] 26.198
Total purchase investments			[8] 320.313

[1] Market value on date of preliminary agreement, if securities. For further breakdown of purchases see tables supplied by railroad pursuant to request of Committee special staff (Appendix 10).
[2] Cash.
[3] $5,214,750 cash; $13,097,712 in noninterest bearing notes. One-half ($6,548,856) principal amount of these notes paid in cash on July 26, 1966 with remaining balance issued in 6 percent Pennsylvania Co. notes on the same date. $3,548,856 principal amount of these notes was paid in cash by Pa. Co. on Feb. 1, 1968 with the remaining $3,000,000 payment being made in cash on Dec. 31, 1969.
[4] $30,381,000 cash; $69,912,000 4⅝ Pa. Co. cum. pfd. $100 par.
[5] $6,697,000 cash; $21,000,000 new cost basis from profit resulting from exchange of stock. For more detailed description of transaction see railroad-prepared tables entitled "Purchase of Investments 1964–1969", Appendix D, Exhibit 10.
[6] Transaction later rescinded to a settlement agreement entered into on Feb. 25, 1971 by both parties to Former Shareholders of Southwest Oil Refining Co. and Royal Petroleum Co. versus Penn Central Co. and approved by the court and entered for judgment on Apr. 9, 1971 in C.A. 70–C–135, U.S. Federal District Court (S.D. Tex., Corpus Christi Division).
[7] $26,198,000 in $3 cum. pfd. stock.
[8] Total cash expended in purchase investments $203,203,000; total equity securities (Pennsylvania Co. cum. pfd. $100 par, $69,912,000; Penn Central Co. $3 cum. preference, $26,198,000); other, $21,000,000 (reportable cost basis resulting from inter-company profit on exchange ef securities).

As noted in the above table, the total amount expended in making non-rail acquisitions was $320,313,000, of which $203,203,000 was in cash (including $13,097,912 in notes paid in cash within four and a half years from date of issue), $96,110,000 in preferred equity securities and $21.0 million in subsidiary common stock (resulting from an intercompany sale of stock between PCTC and the Pennsylvania Co., in which the selling price exceeded the cost by that amount). More specifically, the PRR expended $172,069,000 in cash and issued $69,912,000 in cummulative preferred stock in making its non-rail investments. The NYC paid out $21,337,000 in cash. On the other hand, the merged company itself expended $9,797,000 in cash, $26,196,000 in cumulative preferred stock (which was returned 14 months later as the result of a recission of the transaction), and $21,000,000 in subsidiary common stock. (Note that this $21 million does not really represent a cash outflow from the consolidated Penn Central, but rather represents a transfer of cash from the Pennsylvania Co. to Penn Central

Transportation Co. The implications of this were discussed in the Earnings Maximization section of the Fiscal Policy Analysis.)

Moreover, in determining the cash impact on the railroad of the diversification effort, one should also consider interest paid on debt and the value of equity securities used to finance the acquisitions as well as the dividends and interest received from the subsidiaries. Implicit in this analysis is a recognition of the acute cash shortages faced by the Transportation Co. (and its predecessor component railroads) during the period in which this diversification effort occurred which necessitated borrowing to provide the cash expended. The following table shows the cash cost to the railroad of the interest on the money used in diversification:

INTEREST AND DIVIDENDS PAID ON SECURITIES USED BY RAILROAD IN MAKING SELECTED NONRAIL ACQUISITIONS

[From date of acquisition to Dec. 31, 1970]

	Cumulative net investment	Interest rate (percent)	Compounded investment value	Interest expense	Cumulative interest expense
1963	$28, 176, 000	4. 52	$28, 176, 000	$1, 273, 560	$1, 273, 560
1964	43, 362, 000	4. 63	44, 635, 560	2, 066, 630	3, 340, 190
1965	73, 553, 000	4. 67	76, 893, 190	3, 590, 910	6, 931, 100
1966	82, 241, 000	5. 71	89, 172, 100	5, 091, 730	12, 022, 830
1967	103, 178, 000	6. 25	115, 200, 820	7, 200, 050	19, 222, 880
1968	113, 362, 000	7. 76	132, 584, 880	10, 288, 590	29, 511, 470
1969	160, 573, 000	9. 00	190, 084, 460	17, 107, 600	46, 619, 070
1970	159, 105, 000	10. 00	205, 724, 070	10, 286, 200	56, 905, 270

The cumulative net investment represents the cumulative total net cash outflow for each period which was derived by adding the total cash outlay for diversification, increased by interest and dividends paid on debt and equity securities issued in conjunction with an acquisition and reduced by the interest and dividends paid by the subsidiaries acquired. The rationale for this computation is that the Transportation Co. was not generating enough cash to meet its own cash needs, thus any cash diverted into a diversification effort, regardless of its source, could have been used to reduce the borrowings of the Transportation Co.

As noted in the table, the cumulative, compounded interest expended in making these non-rail acquisitions was almost $57 million, resulting in a combined outlay of $377,218,270, of which $260,105,270 was in cash.

On an individual company basis $18,098,000 was paid out by the Pennsylvania Railroad (raising its commitment to $190,167,000), $1,125,000 was paid out by the New York Central (bringing its total commitment to $22,462,000), and the PCTC's commitment was increased by $37,682,000 to a total of $56,905,000.

In addition, in order to give a complete picture of the total funds committed to the non-rail operations invested in, pursuant to the diversification program, information was requested by the special staff from the company in regard to the quarterly balances of loans and advances from the railroad (PCTC and/or predecessor companies) and railroad subsidiaries (including the Pennsylvania Company) to the company's non-rail subsidiaries. This information is included below:

QUARTERLY BALANCES OF LOANS AND ADVANCES BETWEEN RAILROAD (PCTC AND/OR PREDECESSOR COMPANIES) AND/OR RAILROAD SUBSIDIARIES AND SELECTED ACQUIRED NONRAIL SUBSIDIARIES (JAN. 1, 1960 TO JUNE 20, 1970)

[In thousands]

Company making advance	Company receiving advance	Mar. 31	June 30	Sept. 30	Dec. 31
1964					
American Contract Co	Executive Jet Aviation, Inc				$575
Pennsylvania Co	Buckeye Pipe Line Co			0	
Do	Great Southwest Corp	0	0	0	0
Do	Macco Realty Co				0
Do	Arvida Corp				
Pennsylvania RR., total loans and advances:					
Receivable					575
(Payable to)					0
New York Central RR	Strick Holding Co				

QUARTERLY BALANCES OF LOANS AND ADVANCES BETWEEN RAILROAD (PCTC AND/OR PREDECESSOR COMPANIES) AND/OR RAILROAD SUBSIDIARIES AND SELECTED ACQUIRED NONRAIL SUBSIDIARIES (JAN. 1, 1960 TO JUNE 20, 1970)—Continued

[In thousands]

Company making advance	Company receiving advance	Mar. 31	June 30	Sept. 30	Dec. 31
1965					
American Contract Co	Executive Jet Aviation, Inc	2,893	5,846	8,011	8,163
Pennsylvania Co	Buckeye Pipe Line Co	0	0	0	0
Do	Great Southwest Corp	0	0	0	0
Do	Macco Realty Co			0	0
Do	Arvida Corp			0	0
Pennsylvania RR., total loans and advances:					
Receivable		2,893	5,846	8,011	8,163
(Payable to)					
New York Central RR	Strick Holding Co				
1966					
American Contract Co	Executive Jet Aviation, Inc	9,664	12,050	12,081	13,865
Pennsylvania Co	Buckeye Pipe Line Co	0	0	0	0
Do	Great Southwest Corp	0	0	0	0
Do	Macco Realty Co	0	0	750	0
Do	Arvida Corp	0	0	0	0
Pennsylvania RR., total loans and advances:					
Receivable		9,664	12,050	12,831	13,865
(Payable to)		0	0	0	0
New York Central RR. Co	Strick Holding Co				2,199
1967					
American Contract Co	Executive Jet Aviation, Inc	14,781	15,591	15,976	16,306
Pennsylvania Co	Buckeye Pipe Line Co	0	0	0	0
Do	Great Southwest Corp	0	0	0	3,000
Do	Macco Realty Co	(1,300)	1,350	3,700	6,000
Do	Arvida Corp	0	0	(500)	(250)
Pennsylvania RR., total loans and advances:					
Receivable		14,781	16,981	19,776	25,306
(payable to)		(1,300)	0	(500)	(250)
New York Central RR. Co	Strick Holding Co	6,997	8,997	9,437	9,437
1968					
American Contract Co	Executive Jet Aviation, Inc	3,000	3,000	3,000	3,000
Pennsylvania Co	Buckeye Pipe Line Co	16,421	16,621	16,621	19,020
Do	Great Southwest Corp	7,100	9,100	12,100	12,400
Do	Macco Realty Co	(250)	(250)		
Do	Arvida Corp	0	0	0	0
New York Central RR. Co./Penn Central Transportation Co. (Feb. 1, 1968 to June 20, 1970).	Strick Holding Co	9,437	9,437	9,437	[2] (19,700)
Penn Central Transportation Co., total loans and advances:					
Receivable		35,958	38,158	41,158	35,420
(Payable to)		(250)	(250)	0	(15,000)
1969					
American Contract Co	Executive Jet Aviation, Inc	21,020	21,020	21,020	[3] 21,020
Pennsylvania Co	Buckeye Pipe Line Co	0	0	0	0
Do	Great Southwest Corp	18,550	20,900	21,600	0
Do	Macco Realty Co	([4])			
Do	Arvida Corp	0	0	0	0
Penn Central Transportation Co	Strick Holding Co	(15,000)	(14,984)	(9,384)	([2])
Penn Central Transportation Co., total loans and advances:					
Receivable		39,570	41,920	42,620	21,020
(Payable to)		(19,700)	(19,684)	(14,084)	0
1970					
American Contract Co	Executive Jet Aviation, Inc	21,020	21,020	0	0
Pennsylvania Co	Buckeye Pipe Line Co	(5,500)	0	0	0
Do	Great Southwest Corp	0	0	0	0
Do	Macco Realty Co				
Do	Arvida Corp	0	0	0	0
Penn Central Transportation Co	Strick Holding Co				
Penn Central Transportation Co. total loans and advances:					
Receivable		21,020	21,020	0	0
(Payable to)		(5,500)	0	0	0

[1] Extracted from information submitted by railroad pursuant to request of Committee's special staff and set forth in tables III and IV (Quarterly Balances for the Period Jan. 1, 1960 to June 30, 1970 of Penn Central Transportation Co. (and Railroad Subsidiaries) Loans and Advances Receivable from [Payable To] non-rail subsidiaries); App. D, Exhibit 51.

[2] Strick Holding Co. sold its investment in Strick Corp. (Manufacturing Co.) and Transport Pool for $27,900,000 ($15,000,000 in cash, $9,400,000 in promissory notes, and $4,700,000 in warrants) in 1968. Since the proceeds were paid directly to Penn Central Transportation Co., Strick Holding Co. recorded such payment as an advance to Penn Central Transportation Co. In 1969 after payment of state income taxes for the gain on sale of its subsidiaries in 1968, Strick Holding Co. paid a dividend of approximately $4,800,000 to Penn Central Transportation Co. At date of dividend payment Strick Holding Co.'s balance sheet had receivables due from Penn Central Transportation Co. and a net worth of approximately $19,800,000. Subsequent to the dividend payment, Strick merged into Penn Central Transportation Co. in December, 1969.

[3] Other railroad information contained in an internal report ("Cole Report") on EJA indicated a total debt investment of $21,365,000 at this date.

[4] Macco Realty Co. merged into Great Southwest Corp. in March, 1969.

These tables reflect that by the end of 1967, immediately preceding the merger, the PRR had extended an additional $9,000,000 in loans to Great Southwest Corp. and Macco Realty Co. (excluding the $16,036,000 debt investment in Executive Jet Aviation, Inc. which is accounted for in the purchase investments table (Exhibit 10) because of the nature of its commitment [18]) As of the same date, the NYC had advanced $9,437,000 to Strick Holding Co. By the end of the third quarter of 1969, total advances (excluding Executive Jet Aviation) had risen to $21,600,000 for the PCTC.

SOURCE OF FUNDS

In order to understand exactly what total cash expenditures were made in the combined diversification programs the following table was constructed reflecting the total cash expenditures of the PCTC and its predecessor companies, the NYC and PRR, on a yearly basis:

TOTAL CASH FUNDS EMPLOYED BY PCTC (AND/OR PREDECESSOR COMPANIES) AND SUBSIDIARIES IN REGARD TO SELECTED NONRAIL SUBSIDIARIES (ON A YEARLY BASIS—JAN. 1, 1960 THROUGH JUNE 20, 1970)

Year	Acquisition purchase price [1]	Dividends paid on preferred stock issued as acquisition consideration	Interest paid on debt securities issued as part of acquisition consideration	Increases (decreases) in loans and advances outstanding at end of calendar year	Total cash
PCTC:					
1968	$8,245,856	$3,264,441	$215,084	$10,364,000	$22,089,381
1969	5,000,000	3,264,305	242,707	[2] 6,700,000	15,207,012
1970	0	1,632,152	336,668	0	1,968,820
Total	13,245,856	8,160,898	457,791	17,064,000	39,265,213
NYC:					
1966	0	0	0	2,997,000	2,997,000
1967	15,000,000	0	0	6,440,000	21,440,000
Total	15,000,000	0	0	9,437,000	24,437,000
PRR:					
1963	28,303,000	0	0	0	28,303,000
1964	17,514,983	1,529,785	0	575,000	19,619,768
1965	45,227,849	3,267,542	0	7,588,000	56,083,391
1966	10,393,564	3,264,778	0	6,277,000	19,935,342
1967	946,000	3,264,441	157,318	11,191,000	15,558,759
Total	102,385,396	11,326,546	157,318	25,631,000	139,500,260

[1] Includes commissions and fees paid in connection with acquisition.
[2] Excludes repayment of advances totaling $23,058,000 (along with $2,153,000 in tax allocation payments due PCTC) in the 4th quarter 1969 by Great Southwest Corp. by the issuance of an equivalent amount of its common stock.

Both the PRR and the PCTC publicly stated that the funds used to finance these activities would come from the proceeds of the sale of the N&W common stock holdings. Actual proceeds from the sale of its N&W stock for the period 1/1/60 through 12/31/70 were as follows:

DISPOSITION OF NORFOLK & WESTERN RAILWAY CO. STOCK HELD BY PCTC (AND/OR PREDECESSOR COMPANIES) AND SUBSIDIARIES FROM JAN. 1, 1960 THROUGH DEC. 31, 1970 [1]

Date and company making disposition	Type and amount of interest disposed of (common stock)	Cost basis (book value)	Sale proceeds [2]
July 5, 1963, Pennsylvania Co	37,312 shs.	$2,092,886	$4,506,792
Dec. 19, 1968, Pennsylvania Co	135,000 do	7,572,420	13,831,779
March 1969 to December 1969, Pennsylvania Co	215,799 do	12,104,597	[3] 19,305,247
Total	388,101	21,769,903	37,643,818

[1] Extracted from tables entitled "Investment Analysis—Norfolk and Western Railway Company Stock (Common)" submitted by railroad pursuant to request of Committee special staff (Appendix D, Exhibit 45, p. 576.)
[2] Net proceeds.
[3] Sales by month are as follows: March, 51,440 shares, $4,977,245 net proceeds; June, 45,999 shares, $4,109,555 net proceeds; July, 6,900 shares, $625,272 net proceeds; August, 44,360 shares, $3,894,733 net proceeds; September, 42,900 shares, $3,771,643 net proceeds; October, 21,400 shares, $212,291 net proceeds; November, 7,000 shares, $600,527 net proceeds; December, 14,800 shares, $1,113,981 net proceeds.

[18] Because of provisions of the Federal Aviation Act making ownership of an "air carrier" by a surface transportation company highly improbable, if not impossible, the PRR had taken nearly all of its investment in Executive Jet Aviation, Inc., in debt form.

Quite obviously this expected source did not begin to provide the funds used by the Pennsylvania Railroad for its non-rail acquisitions. However, the 1968–1969 sale proceeds do appear to have been of sufficient magnitude to have financed the non-rail diversification-related cash expenditures incurred by the PCTC.

In addition, in order to assist in determining what funds were employed in financing these activities, the following tables showing all extraordinary additions to the working capital of the railroad(s) is included:

EXTRAORDINARY ADDITIONS TO WORKING CAPITAL OF RAILROAD (JAN. 1, 1960–JUNE 20, 1970)[1]

Date	Company making disposition	Interest disposed of	Proceeds
	PRR:		
July 5, 1963	Pennsylvania Co	37,312 common shares—N & W	$4,506,792
Jan. 20, 1966	PRR	Long Island RR Co. (100 percent of outstanding stock)	[2] 65,000,000
Total extraordinary additions			69,506,792
	PCTC:		
December, 1968	PCTC	Strick Corp. and Transport Pool, Inc. (operating subsidiaries of Strick Holding Co.) (100 percent of outstanding stock).	[3] 15,000,000
Dec. 19, 1968	Pennsylvania Co	135,000 common shares—N & W	13,831,779
Mar. 19, 1969–Dec. 19, 1969	do	215,799 common shares—N & W	19,305,247
Total extraordinary additions			48,137,026
Combined extraordinary additions			117,643,818

[1] Includes major sales of equity investments, rail and nonrail.
[2] $10,000,000 was deposited in December 1965 pursuant to the preliminary agreement of sale dated Dec. 20, 1965. The balance of $55,000,000 was paid on Feb. 7, 1966 after consummation of the transaction.
[3] Cash.

It admittedly cannot be stated with absolute preciseness that the exact funds from one source are those later utilized in a particular manner where such receipt and allocation is done by a large corporation and there is a commingling of all funds received. However, such a tracing process can be accomplished on a net effects basis as was done in this case in conjunction with an examination of the various documents relating to each transaction.[19]

In the case of the PRR, $69,506,792 of the total $139,500,260 cash expended during the period 1963 through 1967 was provided from the July 1963 sale of N&W common stock ($4,506,792) and from the proceeds of the sale of the Long Island Rail Road Co. in early 1966 (resulting in $65,000,000 in cash). The remainder was furnished from working capital of the corporation. On a yearly basis, $23,796,208 was furnished from working capital in 1963 ($28,303,000 less $4,506,792); $19,619,768 came from the same source in 1964; $56,083,391 was supplied by working capital in 1965 (including a $6,000,000 bank loan by the parent railroad to finance the Macco Realty Corp. acquisition); $19,935,342 expended in 1966 was financed entirely by the proceeds of the Long Island Rail Road Co. sale (which could also be said to have replaced the remaining $45,064,658 of working capital used for diversification-related expenses the previous year); and $15,558,759 was financed from working capital in 1967.

In regard to the NYC, the entire amount, $24,437,000 ($2,997,000 in 1966 and $21,440,000 in 1967) was financed from working capital sources of that railroad.

On the other hand, the total cash amount expended by the PCTC on diversification-related costs ($33,228,545) appears to have been covered by proceeds from the 1968–1969 N&W common stock sales ($33,137,026). More specifically, the $22,089,381 expended during 1968 would have been partially financed with proceeds from the December 19, 1968 N&W common stock sale ($13,831,779). The balance, however, was financed from working capital. The total 1969 cash outlay of $10,507,012 was also funded by total proceeds ($19,305,247) of N&W sales during the year. The remaining $8,798,235 effectively replaced the working capital used to finance the 1968 diversification costs not covered by the N&W stock sale proceeds for that year, as well as serving to pro-

[19] See also the railroad-supplied table entitled "Selected Subsidiaries, Analyses of Purchase of Investments, 1964 through 1969," for comments in footnotes, see sources of funds. Appendix D, Exhibit 10, p. 508.

vide nearly all of the 1970 diversification-related (pre-bankruptcy) of $1,632,152.[20]

Rather than dismissing the subject with the observation that the bulk of the diversification or diversification-related expenditures was financed from working capital of the railroad(s) it is believed of significance in this connection to examine what "working capital" consisted of. In order to analyze working capital (technically current assets minus current liabilities), an analysis was made of the earnings from which the current assets of the corporation arose. Admittedly some of the assets have their genesis in funds earned years ago. However, by far the vast majority are generated by current or reasonably current operations. Nonetheless, the period examined covered the eighteen years prior to bankruptcy, or from 1952 through 1969. Net income was divided into rail (including rail-related, e.g., trucking and terminal operations) and non-rail contributions,[21] the purpose of which was to determine the validity of the proposition so often advanced that funds from the company's rail operations were financing its non-rail acquisition activities. The result of this comparison on a total net income and earnings per share basis are set forth in the following tables:

NEW YORK CENTRAL RAILROAD

[In thousands]

Year	Net income			Earnings per share			Dividend per share
	Rail	Nonrail	Total	Rail	Nonrail	Total	
1952	$1,574	$23,142	$24,716	$0.24	$3.29	$3.83	$0.50
1953	14,027	19,975	34,002	2.18	3.10	5.28	1.50
1954	(14,290)	23,478	9,188	(2.22)	3.64	1.42	------
1955	25,513	26,771	52,284	3.94	4.13	8.07	
1956	13,336	25,768	39,104	2.05	3.96	6.01	2.70
1957	(16,275)	24,698	8,423	(2.51)	3.81	1.30	2.73
1958	(33,419)	37,470	4,051	(5.15)	5.77	.62	------
1959	(18,012)	26,415	8,403	(2.77)	4.02	1.25	.25
1960	(24,485)	25,523	1,038	(3.76)	3.92	.16	.50
1961	(38,763)	26,214	(12,549)	(5.94)	4.02	(1.92)	------
1962	(24,255)	20,419	(3,836)	(3.71)	3.12	(.59)	.325
1963	(13,834)	20,873	7,039	(2.11)	3.19	1.08	.50
1964	(437)	27,484	27,047	(.07)	4.13	4.06	1.77
1965	14,112	27,407	41,519	2.06	4.00	6.06	2.60
1966	21,672	28,439 27,552	50,111 49,224	3.14	4.13 4.00	7.27 7.14	3.15
1967	(32,936)	34,170 31,793	1,234 1,143	(4.75)	4.93 4.58	.18 .17	3.12

Note: Nonrail amounts for 1966–67 are shown including results from Strick Holding Co. (top figure) and excluding results from this acquired subsidiary.

PENNSYLVANIA RR. CO.

[In thousands]

Year	Net income			Earnings per share			Dividend per share
	Rail	Nonrail	Total	Rail	Nonrail	Total	
1952	$12,463	$26,849	$39,312	$0.95	$2.04	$2.99	$1.00
1953	11,834	27,041	38,875	.90	2.05	2.95	1.50
1954	(1,378)	19,930	18,552	(.10)	1.51	1.41	.75
1955	21,779	19,405	41,184	1.65	1.47	3.12	1.50
1956	19,881	21,664	41,545	1.51	1.65	3.16	1.55
1957	(2,980)	22,037	19,057	(.22)	1.67	1.45	1.25
1958	(33,685)	37,229	3,544	(2.56)	2.83	.27	.25
1959	(15,177)	22,444	7,267	(1.15)	1.70	.55	.25
1960	(39,713)	31,894	(7,819)	(3.02)	2.43	(.59)	.25
1961	(25,070)	28,586	3,516	(1.90)	2.17	.27	.25
1962	(24,312)	21,102	(3,210)	(1.81)	1.57	(.24)	.25
1963	(12,552)	21,710	9,158	(.93)	1.61	.68	.50
1964	(1,190)	30,323 22,766	29,133 21,576	(.08)	2.20 1.65	2.12 1.57	1.25
1965	3,349	30,548 19,012	33,897 22,361	.24	2.21 1.37	2.45 1.61	2.00
1966	11,799	33,256 13,534	45,055 25,333	.85	2.39 .97	3.24 1.82	2.30
1967	(34,316)	48,408 23,094	14,092 11,222	(2.44)	3.45 1.65	1.01 .79	2.40

Note: Nonrail amounts for 1964 through 1967 are shown including results from the acquired subsidiaries (top figure) and excluding results from these subsidiaries.

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[20] $1,968,820 through 12/31/70.

[21] Included, principally, real estate rental income, capital gains from sale of real estate and dividend income. The real estate activities are briefly described at p. 387, *supra*.

PENN CENTRAL TRANSPORTATION CO.

[In thousands]

	Income					Earnings[1]					
Year	Rail	Nonrail	Net	Extraordinary items	Net including extraordinary items	Rail	Nonrail	Net	Extraordinary items	Net including extraordinary items	Dividend per share
1962	(48,566)	41,520	(7,046)			(2.21)	1.89	(0.32)			0.25
1963	(23,386)	42,583	16,197			(1.20)	1.93	.73			.45
1964	(1,626)	57,806 50,249	56,180 48,623			(.07)	2.58 2.24	2.51 2.17			1.29
1965	17,461	57,954 46,418	75,415 63,879			.77	2.54 2.03	3.31 2.80			1.99
1966	33,470	61,695 41,086	95,165 74,556				2.70 1.80	4.16 3.26			2.35
1967	(67,254)	82,577 54,887	15,323 12,367			(2.92)	3.59 2.39	.67 .53			2.40
1968	(122,422)	98,649 53,894	23,773 68,528	(18,142)	(41,915)	(5.08)	4.10 2.24	.98 2.84	(0.75)	(1.74)	2.30
1969	(191,079)	108,264 62,207	82,815 128,872	(8,818)	(91,632)	(7.92)	4.49 2.58	3.43 5.34	(.37)	(3.80)	1.80

[1] Includes for period 1962–1967 adjustments for exchange of 1.3 shares of PCTC common stock for each N.Y.C. common share pursuant to merger agreement.

Note: Nonrail amounts for 1964 through 1969 are shown including results from the acquired subsidiaries (the top figure) and excluding results from these subsidiaries.

These tables quite clearly show that the company's rail operations were not directly financing non-rail acquisitions. In the case of the PRR for 1952 through 1967, only in one year (1955) did rail earnings exceed non-rail earnings (and then only slightly, $21,779,000 to $19,405,000). In only six of those years (1952–53, 1955–56 and 1965–66) did rail operations contribute anything to net income, losing as much as $39,713,000 in 1960, and $34,316,000 in 1967. Over the entire 16-year period while non-rail operations were contributing $442,426,000 in total reported net earnings,[22] rail operations contributed a total net loss of $129,268,000.

If the losses from passenger operations are eliminated from reported rail earnings, the results (although not as contrasting in later years) are basically the same. While shippers may want to see earnings generated from the rail traffic operations reinvested in the rail plant, the working capital utilized by the PRR appears to have been generated by the company's non-rail activities.

A similar analysis of NYC earnings reveals the same basic conclusions. In only six years of the 16-year period (the same six years in which the PRR also reported earnings: 1952–53, 1955–56, and 1965–66) did the rail operations contribute anything to consolidated income, reaching losses of $38,763,000 in 1961 and $32,936,000 in 1967. Over the entire period total non-rail earnings were $418,196,000, in contrast to rail operation losses totalling $126,492,000 (both figures bearing a striking similarity to comparable PRR figures).

The $34,228,545 expended by the PCTC on diversification-related costs (all but $6,697,000 of which was applied on inherited PRR acquisitions), as discussed above, could well have been said to have been financed by proceeds of N&W common stock sales in 1968–1969. However, assuming *arguendo* that such expenditures were financed from working capital, the table discloses that it was equally as dependent, if not more so, upon non-rail earnings as were its predecessors. Non-rail earnings for 1968–1969 totalled $206,913,000, as compared to total rail losses of $313,501,000. (Excluding the acquired subsidiaries, total non-rail income nonetheless reached $116,101,000). Once again, it appears that such expenditures were not financed by rail operations.

It should be noted at this point that the "earnings inflation" policy of the PRR and the PC in particular distorted the income figures by an indeterminate amount thus making it necessary to exercise some caution in analyzing the flow of cash. As is pointed out in other segments of this report, reported earnings differed substantially from cash realities in many instances.

[22] Figures include earnings from acquired non-rail subsidiaries in 1964 through 1967. Excluding these earnings, total non-rail net income for the period 1952–1967 amounted to $378,297,000.

Investment Pattern

An examination of the non-rail investments made by the PRR reflect entry into three basic industries: (1) petroleum pipeline distribution; (2) real estate development; and (3) air transportation.

Entry into the first of these areas was accomplished by the acquisition of Buckeye Pipe Line Co. in July, 1964. As was discussed previously, consideration of the acquisition of a pipeline company was begun as early as 1960 not so much at that time with diversification itself as the primary objective (although it did serve as a factor) but in order to attempt to gain a more efficient use of its existing plant through use of its rights-of-way.[23] However, by the time of acquisition, Buckeye was described by S. T. Saunders in an accompanying press release as "an important step in a long-range program of diversification." [24] A memorandum dated May 10, 1963, prepared in connection with the Buckeye acquisition, gives some indication of the considerations which the railroad was, ostensibly, utilizing in its acquisition programs. At page 1 of this memorandum it was stated "Logically, diversification should be into an industry which supplements or complements the basic operations and one which in concept and philosophy is readily understood by the management of the parent company." [25] The application of the latter considerations, other than the fact that the same geographical areas were served by both corporations, is not apparent.

Another factor, discussed earlier, which was to be of major consideration in regard to type of operations acquired, was rate of return. The Bevan memorandum dated April 30, 1963 (in regard to possible courses of action available upon disposition of the N&W holdings) [26] pointed out the necessity of obtaining a high rate of return from any acquisition in order to replace the substantial 85 percent tax free cash dividend income from the N&W shares. It is again difficult to see how the latter consideration (at least from the standpoint of cash return), which would seemingly be of great importance to the cash poor railroad (regardless of the N&W income replacement considerations), played the least significant role in the selection of Buckeye, or, more especially, that of the real estate development acquisitions. This question will, however, be discussed in more detail later on in this chapter in connection with the rate of return (in terms of both reportable income and cash) achieved by the PRR on its non-rail acquisitions.

The second industry area entered by the railroad, and the one in which it concentrated its major effort, was that of real estate development. Initial entry into this product market was accomplished with the acquisition of controlling interest of Great Southwest Corporation (GSC) in June, 1964. Called "a major step in the Pennsylvania's long-range program of diversification" by S. T. Saunders,[27] GSC was viewed as being the nucleus for further diversification in real estate operations (and was in fact later utilized as such with the acquisition of Macco Realty Corp. and its eventual merger into GSC in early 1969, the additional acquisition of I. C. Deal Corp. in 1969, and GSC's own expansionary efforts). More specifically, GSC was (initially) primarily in the business of developing properties for lease for commercial use within an industrial park. To supplement lease income, the company also developed and operated a Disneyland-type amusement park with a historical theme, with an accompanying motor hotel-restaurant operation, in order to generate sufficient cash flow. Such operations were carried on at two locations, between Dallas-Ft. Worth, Texas and near Atlanta, Georgia.

The second real estate development firm acquired was that of Arvida Corporation, controlling interest in which was purchased on July 26, 1965, about one year following the GSC transaction. Arvida, a Florida firm, possessed sub-

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[23] No use of the railroad's rights-of-way has been made for this purpose since acquisition of Buckeye.

[24] Appendix D, Exhibit 11, p. 516.

[25] See Appendix D, Exhibit 4, p. 494, for full text of this memorandum. Of course, the argument normally advanced in nearly all diversification programs, that of seeking to introduce earnings stability resulting from a wider earnings base (by acquiring companies whose operations are either subject to little or no cyclical pressures or whose business cycle is different from that of the parent company) was also present.

[26] In Text, p. 389. *Supra.*

[27] PRR press release dated June 24, 1964, Appendix D, Exhibit 12, p. 517.

stantial holdings on both the East Coast of Florida in the Miami-Ft. Lauderdale-Boca Raton-Palm Beach area, and around Sarasota on the West Coast. Holdings at the time of acquisition included major resort, residential and commercial properties. Operations were, moreover, primarily concerned with development and sale, although certain leasing and investment activities were also included.

The third in a succession of real estate operation acquisitions was that of Macco Realty Corporation, effected by the railroad less than a month later by purchase of controlling interest.[28] Macco, a California company, was one of the leading residential real estate development companies in the Los Angeles area, with extensive holdings in Los Angeles, Riverside and Orange Counties. The Macco acquisition, made at the urging of Great Southwest Corporation, was termed by railroad officials as a transaction which would conclude its real estate investment activities.

Few stated reasons were to be found anywhere in regard to the rationale employed by the railroad for its decision to enter the real estate development field. Certain reasons, however, for acquisition of GSC and entry into real estate operations were contained in an internal memorandum [29] of the investment adviser to the railroad—for this, and all its acquisitions—Glore Forgan, William R. Staats and Company, which was prepared in connection with the transaction. These reasons were: ". . . the experience of the railroad in industrial property management," [presumably through its industrial development department]; ". . . the stability and growth of GSC operations which could help overcome the cyclical character of the railroad business; and the opportunity to participate in the growth of an area which is expanding at a much faster rate than the operating territory of PRR." In addition, the PRR press release in connection with the acquisition also gives reference to the railroad's prior "experience" in real estate matters.

The railroad had some real estate experience in that it did own some commercial properties including office buildings from which it derived rental income, had engaged in the sale and/or lease of some of its own real property adjacent to its real operations (to potential shippers), and managed its own properties. While some of the business development activities of the railroad may have given some substance to the claim that it had experience which could be related to the development of the industrial district projects of GSC (excluding the amusement park-motor hotel-restaurant operations), it hardly follows that PRR officials were also experienced in residential property development and sales, which formed the major part of the railroad's acquired real estate activities (through Arvida and Macco Realty—and for that matter much of GSC's own later activities as the result of its acquisition of I.C. Deal Co.).

The "stability and growth" of GSC operations is an assertion whose validity was highly questionable not only because of its short history of operations, several years of which resulted in losses, but more importantly in view of the volatile nature of the real estate industry itself because of the large role that fluctuating interest rates and local economies play (most notably in connection with residential development operations). Furthermore what real estate experience the PRR did possess should have provided ample warning of the extraordinary financing demands normally made by such operations. The almost endless need for external financing results from several factors including (1) having funds tied up in properties which are unsold or held for future development; (2) a high rate of receivables principally in the form of second trust notes; (3) expansionary purposes (including e.g. the continual need to purchase land for future development). Because of this demonstrated need for financing, all funds generated internally are invariably used to supplement working capital and it is a rarity that dividends are paid. The principal return on investment must ordinarily come from capital gains to be realized from stock appreciation possibilities.

Unfortunately, as will be discussed later in more detail, and as should certainly have been foreseen at the time of acquisition, the GSC and Macco Realty acquisitions were continual cash drains on the railroad's already depleted

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[28] Conditioned on a later tender offer of September 13, 1965, which successfully increased ownership to in excess of 80 percent (to approximately 98 percent).

[29] Memorandum dated February 18, 1964, from "WDS" [Walter D. Scott] to Charles J. Hodge, Appendix D, Exhibit 13, p. 518.

cash reserves (by the end of the third quarter 1969, in excess of $23.8 million had been advanced to both companies—$9 million of which had been advanced by the PRR by the end of 1967).[30] Moreover, no cash dividends have ever been paid by Arvida or Macco Realty and only $4,266,441 in cash dividends was received from GSC in appropriately six and a half years of ownership from 1964–1970 ($297,500 to the PRR from 1964 through 1967) on a total investment of $51.286 million.

In addition, although there were satisfactory reportable earnings generated which were consolidated in the income statement of the railroad, part of these paper profits were produced by questionable accounting practices.[31] Such reported earnings had the further undesirable effects of covering over the failing rail operations and serving as a distraction to the continuing cash drain which these subsidiaries were having on the railroad. Furthermore, the volatile nature of the industry was eventually reflected in the reported earnings of GSC (including Macco) in 1970—a loss of nearly $132 million was reported for that year, giving the railroad a total net loss of over $80 million for that company's operations from 1964–70.

Of significance in this connection was the attitude of the NYC toward its proposed merger partner's real estate diversification activities. Comments contained in the minutes of a meeting of the NYC Board of Directors on May 14, 1966, at which was considered a request by the PRR to raise its ceiling on debt (arrived at in a pre-merger agreement between the two railroads) in order to include debt incurred principally as the result of its four major acquisitions, the Central's Board expressed reservations about the wisdom of the PRR's entering the real estate development business.[32] However, the Board grudgingly consented to the request that the aggregate debt limit be raised to $195 million (nearly double the $100 million ceiling originally agreed to).

Entry into other modes of transportation is of course either prohibited or effectively prohibited by law.[33] However, of all areas of business operations which the railroad could have entered, considering its cash needs, real estate development was perhaps the most ill-suited. Although not normally offering the spectacular stock appreciation [and accompanying decline] possibilities that real estate does, many other forms of business activity could have

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[30] Repayment of the $23.8 million in advances was made by GSC on December 31, 1969, by the issuance of its common stock in an equivalent amount—which nearly immediately suffered a severe decline in value (from 15¾ [bid] on 12/31/69 to 2⅜ [bid] on 12/31/70, or 85 percent—declining even further to 1⅝ [bid] on 12/31/71).

[31] Accounting and tax provisions permit the reporting of profit on a real estate sale in the year in which the sale occurred despite the fact that only a small down payment might be made and the remainder repayable in installments over 20–30 years. For example, because GSC was not achieving its income goals in 1968 and 1969, it attempted to bolster them by resorting to sale of its amusement park operations ("Six Flags Over Texas," and "Six Flags Over Georgia"). Both sales, clearly undertaken in order to maximize consolidated income for the year in which sold, did result in substantial short-term profits, but, of course, also relieved the corporation of two of its principal income producers. Moreover, substantial controversy surrounded the reporting of their sales. One-half of the entire profit for GSC in 1969 resulted from gain on the sale of "Six Flags Over Texas." Gross proceeds from the sale totalled $40 million, but only $1.7 million was actually received in cash with the balance due in installments until the end of the century. Under permissible Internal Revenue Service tax provisions the entire profit ($8.75 million) was reportable in the year of sale. Furthermore, the corporation changed its original accounting designation of the transaction from that of extraordinary gain (because of its size and nature) to that of ordinary income, thereby avoiding a financial statement notation as to the nature of the transaction and its effect on the corporation's income for the year. In addition, less than a year earlier, on December 31, 1968, the corporation "sold" Six Flags Over Georgia", generating a net gain of $4.8 million from a transaction whereby the purchaser contributed the amusement park to a limited partnership in which the selling corporation was the general partner and operator. Once again, cash produced by this sale was negligible in that out of a total purchase price of $23 million, GSC took back a 7% note in the amount of $21 million. In the same year, GSC generated additional net gain of $1.5 million on a sale of securities by Macco which also bolstered income for the year.

[32] Appendix D, Exhibit 14, p. 523.

[33] E.g., ownership of an air carrier, a non-rail related trucking company, a freight forwarder, as well as water carriers are all effectively prohibited. Ownership or control of an "air carrier" by a surface transportation company is prohibited by Section 408(b) of the Federal Aviation Act, unless such ownership "promotes the public interest . . . (is) to the public advantage, and will not restrain competition." Although the existence of ownership of convertible debentures of Slick Airways by the C&O Railroad Co. and of similar debentures of Flying Tiger Lines by the NYC Railroad Co. was permitted by the CAB to continue, there was substantial reason to believe that acquisition of an "air carrier" by a surface transportation company would not be permitted, not only from the restraint of competition standpoint but from previous decisions relying on Section 408 and reflecting the established policy of the CAB that ". . . our air transportation system shall be free of control by surface carriers" as the controlling consideration in the application of the "public convenience and necessity standard" of Section 401. (Railway Express Agency, Freight Forwarder Application, 27 CAB 500, 502 [1958]).

Ownership of trucking companies by railroads is similarly effectively prohibited by Section 5(2)(d) of the Interstate Commerce Act with its requirements that such ownership "promote the public interest to public advantage." However, such ownership has, of course, been approved by the Commission in situations where the trucking activities involved piggyback and other rail-related operations.

Ownership of freight forwarders and water carriers by surface transportation companies are also basically prohibited.

provided the growth and return on investment objectives without the extraordinary financing demands and accompanying non-payment of cash dividends that real estate developmet operations present (e.g. consumer services or consumer goods, to name only two). Given the objectives of the program and the railroad's only slight acquaintance with real estate activities of the type acquired, it is apparent that factors other than cash generation were determinative. For example, real estate offered opportunities for inflating the company's public financial picture as discussed in the Earnings Maximization section of the Fiscal Policy Analysis portion of this report.

Explanation of how such a step was taken is perhaps best made by an examination of what might be described as the complex interrelationship of the railroad and its investment banking adviser, Glore Forgan, Wm. R. Staats and Co. This relationship evolved from the friendship of David C. Bevan, Chairman of the Finance Committee of the PRR, and Charles J. Hodge, the Chairman of the Executive Committee of Glore Forgan. The two men had been friends on a social as well as on a business basis for a considerable length of time,[34] Hodge openly considering himself an "intimate friend of the family." Moreover, both belonged to a fishing and social club called the "Silverfish," consisting of twelve men, most of whom were high-ranking officials in finance-oriented business operations.[35]

On a business basis, through Hodge's contact with Bevan, Glore Forgan had acted as the broker through which both Pennsylvania Co. and the Contingent Compensation Fund of the railroad had made their securities purchases in the early 1960's. In 1960 Hodge himself was appointed a member of the "Committee of Potential Pipelines in the Pennsylvania Railroad System" whose study produced the confidential memorandum, of which he was the author, recommending the acquisition of Buckeye Pipe Line Co. Moreover, in October, 1961 Hodge was apparently sent as an emissary on behalf of the railroad to Switzerland in an attempt to convince certain Swiss banking interests (who asserted at the time that they controlled some 1.3 million PRR common shares) that they should vote for the then reactivated PRR-NYC merger proposal,[36] giving assurances to the banks that they could obtain representation on the PRR Board of Directors, if they so desired.[37] Also, during the early 1960's after reactivation of the merger plans, the Staats firm itself served as an investment adviser to both the PRR and NYC railroads in the working out of an agreeable stock exchange ratio (which the railroads' principal underwriters had apparently been unable to accomplish).

Hodge cultivated the relationship even further by giving a dinner in New York in honor of S. T. Saunders, D. C. Bevan and H. R. Pevler (President of the N&W at the time), soon after Saunders' appointment as PRR Board Chairman, and attended by a large group of top officials of the nation's largest financial institutions,[38]—and later (in 1965) even arranging part of the itinerary of a European tour by Saunders.[39]

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[34] ". . . (F)or twenty years" according to a letter dated 3/29/65 from Hodge to A. T. Brown, Sales Administrator, Arvida Realty Sales, Inc., in support of Bevan's application for purchase of an apartment in an Arvida-owned condominium in Boca Raton, Fla. Appendix D, Exhibit 15, p. 524. The casualness of the relationship is further evidenced by the fact that in connection with a similar apartment which Hodge purchased, the title insurance policy for it was secured on his behalf by an attorney in the railroad's legal department. Appendix D, Exhibit 16, p. 525.

[35] See Appendix D, Exhibit 17, p. 526.

[36] Letter dated 10/16/61 from C. J. Hodge to D. C. Bevan, Appendix D, Exhibit 18, p. 526.

[37] ". . . (P)roviding that the representative was not an Investment Banker" (see letter dated 11/15/61 from an official of one of the Swiss banks to Francis N. Rosenbaum Appendix D, Exhibit 19. That such a mission would be undertaken on behalf of the railroad by an independent third party (whose only previous connection with the railroad was his friendship with Bevan and his services in connection with the pipeline study) apparently without authorization by the PRR Board of Directors, or its Chairman, is highly unusual, if not extraordinary.

[38] See document entitled "Dinner Given by J. Russell Forgan and C. J. Hodge. The Links Club, October 30, 1963," Appendix D, Exhibit 20, p. 527.

[39] See letter dated 4/6/65 from C. J. Hodge to D. C. Bevan and other various pieces of correspondence, Appendix D, Exhibit 21, p. 528. Moreover, an April 5, 1965, letter refers to a meeting arranged by Hodge between Saunders and a group of "Spanish friends" which included representatives of a manufacturer of freight cars in Madrid, called "Euskalduna," and a "Carlos Mendoza, the head of RENFE, which is the government-controlled [sic] railroad monopoly in Spain [which] would be a proper platform for the building up of a simpatico between Stuart, the Pennsylvania and the Spanish." According to Hodge's letter, the Spanish group was seeking advice in regard to expansion of rail freight car manufacturing facilities. However, Hodge states in the letter "There is no question here of requesting financing. Any money required will be available in Spain from the Spanish. This is merely an effort to bring the Spanish closer to the Pennsylvania Railroad." Just what the purpose of bringing the "Spanish closer to the Pennsylvania" was, was not clear from the letter.

The entire purpose of setting forth this otherwise irrelevant material regarding the personal relationship existing between Hodge and Bevan, is to question the objectivity, if any, which was exercised in regard to analysis of the acquisition proposals submitted by Hodge to the railroad. Because of the friendship between the two men which had developed over the years and the trust arising therefrom, the objectivity and thoroughness of examination accompanying normal arms-length transactions may well have been absent in the Hodge-Bevan situation.[40] From the outset of its program, Hodge (and the Wm. R. Staats & Co. firm—later Glore Forgan, Wm. R. Staats & Co.) was the principal, or more accurately, sole investment adviser to the PRR.[41] Beginning in 1964 with the Buckeye Pipe Line and Great Southwest Corporation transactions, Glore Forgan received major investment advisory fees in connection with every acquisition made by the railroad (as well as acquisition-related stock purchase commissions). These, and other acquisition-related advisory and stock commission fees are set forth in the following table:

COMMISSIONS AND OTHER FEES PAID BY RAILROAD AND/OR RAILROAD SUBSIDIARIES IN CONNECTION WITH ACQUISITION OF STOCK OF SELECTED NONRAIL SUBSIDIARIES [1]

Acquisition and date	Company, partnership or individual receiving fee	Amount and form of consideration [2]	Company making payment
Buckeye Pipe Line Co., January 1963 to August 1964.	Glore Forgen, Wm. R. Steats & Co	[3] $314, 893	Delbay Corp. ($47,184) (initial stock acquisitions)
	Miscellaneous investment brokerage firms	[4] 56, 786	Pennsylvania Co. ($331,294)
	Covington & Burling	[5] 4, 300	
	Berl, Potter & Anderson	[5] 2, 500	
Total		378, 478	
Great Southwest Corp., February 1962 to December 1969.	Glore Forgan, Wm. R. Staats & Co	[6] 263, 650	Pennsylvania Co.
	Miscellaneous investment brokerage firms	[4] 11, 207	Do.
Total		274, 855	
Arvida Corp., July 1965 to December 1966	Glore Forgan, Wm. R. Staets & Co	[7] 317. 696	Do.
	Miscellaneous investment brokerage firms	[4] 18, 600	Do.
Total		326, 296	
Macco Realty Corp., October 1965 to July 1966	Glore Forgan, Wm. R. Staats & Co	[8] 642, 846	Macco Development Corp.
	To various brokers under tender offer through Bank of America Trust and Savings Association.	[4] 455, 211	
	Kindel and Anderson	[5] 100, 765	
Total		1, 198, 822	
Executive Jet Aviation, October 1964		([9])	
Strick Co., November 1966		([9])	
Total		2, 178, 451	

[1] Information extracted from "Table VI—Commissions and other fees paid in connection with acquisition of stock during period Jan. 1, 1960, to June 20, 1970," submitted by railroad. Appendix D, Exhibit 51, p. 618.
[2] Market value at date of payment, if securities.
[3] $162,000 advisory fee; $152,893 stock commissions.
[4] Stock commissions.
[5] Legal fees.
[6] $259,183 advisory fee; $4,464 stock commissions.
[7] 45,000 shares of Arvida common received as advisory fee, July 25, 1965 (market value of 6⅞ as of that date or $308,395) plus $9,321 stock commissions.
[8] Advisory fee partially received on Aug. 13, 1965, in form of 10 percent (10,000 common shares) participation in Macco Development Corp., a P.R.R. subsidiary established solely to facilitate acquisition of Macco Realty Corp. (a nominal contribution of $10,000 was made for this interest by Glore Forgan—far below its actual value). After a series of related merger transactions, this interest was eventually exchanged for shares of Great Southwest Corp. common (the merger between Macco Realty and GSC having taken place earlier) with a market value of $641,450, shares with an approximate value of $300,000 were then distributed to the firm and to partners, with stock valued in the amount of $385,705 going to officers.
[9] Fees paid, if any, unknown. Railroad accounting records indicate no fees were paid.

As can be seen from the above table, Glore Forgan received a total of $1,539,085 in advisory fees and stock commissions relating to the four non-rail acquisitions made by the PRR ($589,260 of which was in cash and $949,285 in

[40] In addition Hodge's personal files reveal numerous pieces of correspondence between Hodge and Saunders, as well as Bevan, indicating a freindship with Saunders. However, quite obviously the bonds were stronger between Hodge and Bevan.

[41] By 1967 Hodge's dominant role in the railroad's diversification program had apparently become well known to the financial community. This comment appeared on a note dated May 15, 1967, from Gerald H. McGinley, a partner of the investment banking firm of Kidder, Peabody and Co., to Hodge, which was attached to a Kidder, Peabody research department report on the PRR: "General—so much of this is you—I know you will find the attached most interesting."

subsidiary stock).[42] C. J. Hodge was also appointed to the board of directors of Buckeye, Arvida and Macco at the recommendation of D. C. Bevan and concurrence of S. T. Saunders.[43] He was already a member of the board of Great Southwest at the time of its acquisition by the PRR and continued on thereafter.

In regard to the acquisition of Great Southwest Corp. and the railroad's entry into real estate development, it was Charles J. Hodge who brought the acquisition to the railroad and provided the investment services in connection with the transaction.[44] Examination of the surface acquisition rationale apparently employed by Hodge was presented above. A further analysis reveals that other reasons may have consciously or subconsciously prompted his urging the railroad to take the action that it did. Not only was there the possibility of a large advisory fee in connection with the GSC transaction, but from his position as a member of the company's board of directors and investment banking adviser to GSC, he would have known of its expansionary (through acquisition) plans and the greater fee possibilities obtainable here if it were a subsidiary of the PRR whose larger financial backing would permit greater acquisition potential. For example, Macco Realty had been under study by GSC for over a year before its acquisition was later made by a PRR subsidiary established specifically to make the acquisition because GSC's debt-ridden financial structure would not permit its own acquisition of Macco. Hodge would have had knowledge of these plans. (In addition GSC itself also later acquired I. C. Deal Co., a residential developer, and Richardson Mobile Homes, Inc., the nation's second largest mobile homes producer.) Furthermore, Hodge and other members of his firm also possessed GSC stock interests themselves which could have been influencing factors in the recommendation to the railroad to purchase GSC.[45]

To assess the extent to which the above-mentioned factors influenced the Hodge and Glore Forgan recommendation to the PRR that it acquire GSC and enter the real estate development business would be a matter of speculation. Nonetheless (it is clear that from the railroad's cash starvation point of view), the recommendation was a poor one. Bevan himself had the opportunity and absolute responsibility to evaluate the suggestion. However, as stated above, his friendship with Hodge and apparent trust in his judgment may well have impaired the objectivity and analysis he would have employed in a normal arms-length transaction.

The investment in Executive Jet Aviation, Inc., ostensibly an air taxi operation, actually was the vehicle through which the PRR hoped to enter a

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[42] The suggested size of the first advisory fee ($200.000) apparently prompted Bevan to request that Hodge submit a memorandum setting forth in detail what services Glore Forgan had performed in connection with the acquisition, presumably in justification of the fee. This Hodge did in a letter dated August 3. 1964, which produced a further request from Bevan that Hodge also submit, presumably for purposes of comparison, a list of merger fees charged by Glore Forgan and other investment banking firms in other transactions, as well as a breakdown of the Buckeye fee into its proper factors (i.e., advisory fee and brokerage commissions in connection with the acquisition of a large block of shares). This Hodge also did (breaking down the fee into $132,000 and $38.000, respectively) which he forwarded along with a letter dated August 21, 1964. Full text of letters appears in Appendix D, Exhibit 22, p. 531.

See also Glore Forgan inter-office memoranda dated July 30, 1965 and August 4, 1965 from Donald Royce, Sr. to Charles Hodge and from "RWG" to Charles Hodge, respectively, congratulating Hodge on the Arvida deal—the former also remarking "It certainly comes at a time when we can use the fee" and the latter commenting on "just what this means in dollars and cents."] $317,696 in Arvida stock and stock commissions, Appendix D, Exhibit 24, p. 533.

[43] See letters dated September 28, 1964 and July 19, 1965 from D. C. Bevan to S. T. Saunders, Appendix D, Exhibit 23, p. 532.

[44] In this connection see letter dated August 19, 1964 from C. J. Hodge to S. T. Saunders wherein Hodge states, "I assure you that the group from Texas [Great Southwest Corp.] is of the highest standard. I repeat to you that I have dedicated myself to the service of yourself and to Dave, and to the Pennsylvania in attempting to help you build a real great empire." Appendix D, Exhibit 25, p. 533.

[45] The Glore Forgan firm had been introduced to GSC back in August, 1958, when a Herbert Herff came to J. Russell Forgan, a senior partner of the firm, with a financing proposition for the then Great Southwest Development Corporation. Details of this meeting are provided in a memorandum dated August 22, 1958, from C. J. Hodge to other partners of the firm, Appendix D, Exhibit 26, p. 533. Briefly the proposition was that GSC wished to borrow $2.75 million over 36 months and Herff would be paid a $1 million bonus over that period if he could raise the funds. Although Herff stated he would lend the funds himself if he could find no other sources, it was finally agreed that Ezra K. Zilkha, later a member of the GSC Board, would lend the money, receiving 45 percent of the bonus, with Herff receiving 45 percent and Glore Forgan 10 percent as placement fees. Shortly thereafter certain Glore Forgan partners, including Hodge, began to accumulate GSC stock. [In addition, in payment for their Macco Realty acquisition investment advisory services, Glore Forgan received a 10 percent stock interest in Macco Development Corp. (the PRR subsidiary established solely to make the acquisition) whose existence was understood from its inception to be eventually merged with GSC and later was, in March 1969, with Glore Forgan receiving for its interest, GSC common stock valued at $641,450, approximately $300,000 of which was distributed to the firm and its partners and $385,705 to its officers.]

third area of business operations, that of air cargo transportation.[46] The railroad had never disputed, and in fact candidly admitted that it wished to become an integrated transportation company ("a transportation department store").[47] The basic reason for the adoption of such an approach was principally the fear by the railroads of the competitive impact in all areas but certain bulk commodities that air freight operations would have on rail freight traffic.[48] Investment in EJA was, however, made in the face of existing Federal aviation laws which in effect prohibited ownership of such air transportation operations by a surface transportation company [49] (prompting the railroad to attempt to avoid these "ownership" prohibitions, at least in form, by making their investment principally in debt securities). To categorize the risk taken by the railroad that (1) the ownership of non-voting securities (primarily debt) would not be construed as "ownership" or "control" of an air carrier; or (2) the CAB would make a policy change and find that ownership of EJA by the railroad, (even as its operations were contemplated) was in the "public interest and to the public advantage" and not in restraint of competition; or that (3) Congress would pass legislation permitting such ownership, as injudicious would, however, be charitable regardless of the business merits of the objective. As might well have been foreseen, when EJA attempted to expand its operations from its original air taxi activities (which might conceivably have permitted railroad ownership) to supplemental carrier status (permitting nationwide passenger and cargo charter operations) the Civil Aeronautics Board denied its approval and ordered the railroad to divest itself of its entire EJA investment.[50] This investment (totalling $21.365 million) was eventually disposed of by the railroad in January, 1972 for $900,000—a net loss of approximately $20.465 million. Besides the almost certain illegality of the investment objective, and consequent enormous risks attendant thereto, EJA itself was just commencing operations, and in need of large amounts of external financing in order to acquire the jet aircraft needed in the business (most of which was provided by the railroad). Certainly there was little hope of an immediate or even near-term return on investment (in worthwhile amounts) in either reportable earnings, or more certainly, cash dividends. EJA, like the real estate companies acquired, was another example of extremely poor investment judgment in light of the needs of the railroad.[51]

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[46] EJA was also brought to the attention of the railroad by C. J. Hodge who later stated "I screened and proposed EJA. I thought any railroad management not aware of what's coming in air freight was not doing its job." ("End of a bizarre overseas venture," *Business Week*, August 16, 1969, pp. 122–123). Moreover, both the Glore Forgan firm itself and several individual partners, including Hodge and S. A. Hartwell, who were both members of the EJA Board of Directors, possessed substantial equity holdings in EJA from the inception of the company.

[47] See list of "Reasons Why Transportation Diversification Should Benefit the Public," prepared by PCTC legal department, appearing as attachment to memorandum dated 3/10/69 by Basil Cole, Vice Pres., Administration, PCTC (and executive assistant to S. T. Saunders) to all PCTC department heads, with accompanying comments by certain railroad officials. Appendix D, Exhibit 27, p. 535. See also letter dated 1/23/67 from S. T. Saunders to Hon. Alan S. Boyd, Secretary, U.S. Department of Transportation, Appendix D, Exhibit 29, p. 539.

[48] Remarks by S. T. Saunders to the New York Traffic Club on February 20, 1969, restate these reasons:

"Unless railroads are permitted to diversify into other forms of transportation, within a relatively short period of time air cargo will have the same effect on railroad freight as passenger airlines have had on long-haul and intermediate range railroad passenger service since World War II.

The impact of airborne freight could be the last straw for railroad freight services except certain bulk commodities, and railroads cannot survive on this sort of traffic alone. This imminent new threat underscores the need for the revision of laws and regulatory practices which prohibit railroads from ownership of other modes of transportation," Appendix D, Exhibit 28, p. 539.

[49] See discussion of applicable FAA provisions at footnote 33, *supra*.

[50] Executive Jet Aviation, Inc. Docket No. 17657 et al. Order No. 69–10–67 entered October 14, 1969. In addition, for its role in a series of illegal actions, including the pursuit of extensive foreign supplemental carrier acquisition activities resulting in actual control over several carriers (before obtaining requisite CAB approval), and the leasing of certain owned jet aircraft to these companies without disclosing such ownership interests to the CAB prior to receiving authority to lease the aircraft, the CAB levied a fine of $65,000 on the railroad (and $5,000 on EJA).

[51] The bizarre story of the EJA and PRR (and later Penn Central) relationship has been chronicled in detail in numerous instances including Hearings before the Senate Committee on Commerce, Failing Railroads, Part 2, Serial No. 91–90, 91st Congress, 2d Session. A lengthy staff report of the U.S. House of Representatives, Committee on Banking and Currency (The Penn Central Failure and the Role of Financial Institutions. Part II, "Case Study of Penn Central Subsidiary; Executive Jet Aviation. Staff Report of the Committee on Banking and Currency, dated December 21, 1970, U.S. House of Representatives, 91st Cong., 2d Sess.) and in numerous magazine and newspaper articles (e.g. see "Is the Sky the Limit for the Pennsy," *Business Week*, December 10, 1966: "End of a Bizarre Venture," *Business Week*, August 16, 1969, beginning at p. 122; "IAB: Aviations Big Whodunit." *American Aviation*, December 23, 1968, pp. 11–13; "CAB Studies Charge That Penn Central Sought Illegal Foothold in Air Transportation," *Wall Street Journal*, August 15, 1969; "Penn Central Told to Shed Control of Flying Service." *Wall Street Journal*, October 16, 1969). It is not the purpose of this report to go into these details again other than to note in passing that the manner in which EJA was run by its top management gives testimony to the lack of PRR managerial guidance given to the operations of companies invested in (the special circumstances perhaps in existence here, that of trying to avoid the appearance of "control," notwithstanding).

The sole acquisition which the NYC made, that of Strick Corporation, was not as an abrupt departure from rail activities, into a totally unrelated product market, as were those of the PRR. Strick, a manufacturer of lightweight aluminum trailers and vans and containerized equipment for the railroad industry, was a company whose operations had been known to the NYC since the advent of the latter's Flexi-Van service instituted in 1956. The combination trailer-rail shipping container used by the NYC was manufactured by Strick and for that matter developed for that purpose. Moreover, the NYC was also a trailer customer of Strick for other parts of its rail-truck operations. Acquisition of Strick was therefore a partial integration of these operations, as well as an attempt to gain a greater return on investment. However, because of its own expansionary plans Strick too became an unexpected drain (in terms of advances) on the cash resources of the railroad. Rather than permit continued advances, at the expense of rail projects, many of which were being turned down, the Central put a stop to further loans the first year after acquisition.[52] When Strick profits fell off the following year, and the merged railroad made financing arrangements to acquire trailers needed in its trucking operations at more economically advantageous terms than it could obtain by leasing them from Strick, the Strick companies were sold.[53]

The PCTC, moreover, its top management perhaps realizing the mistake that had been made by the PRR in concentrating its efforts in real estate, and beginning to forcefully understand the illegality of its EJA venture by that time, concentrated its initial diversification efforts on the acquisition of Kayser-Roth, the nation's leading apparel manufacturer, as an entry to the consumer good field. The refined, or perhaps more accurately, defined (apparently for the first time) fundamental investment objectives that were set forth by S. T. Saunders in his remarks made to the PCTC Board in connection with the consideration of the Kayser-Roth proposal are also of note—reflecting attempts to eliminate mistakes of the past (". . . a company must be sufficiently large and established as a going concern . . ." [the three real estate development companies and EJA were all young companies with attendant financing demands and unstable earnings performances]; "(t)ransportation companies . . . are not prime candidates because of potential conflict with certain anti-trust theories and regulatory policies . . ."; "(M)oreover, there are obvious advantages in using securities, rather than cash . . .").[54] For the purposes of analysis it would have been useful to compare the results of the Kayser-Roth transaction with the other diversification efforts. But Kayser-Roth officials terminated discussions in October, 1968.

The PCTC's investment (23 percent interest) in Madison Square Garden Corporation, rather than adding to any established investment pattern (i.e. real estate operations) or reflecting any new departure therefrom, represented primarily an opportunity for the railroad to exchange its stock interest in its Penn Terminal Co. (through which it owned Pennsylvania Station in New York City) for that in a more promising enterprise whose physical plant had been erected over the site of the railroad subsidiary's property.

The sole other investment made by the merged company was the acquisition of Southwestern Oil Refining Co. (and its wholly-owned subsidiary Royal Pe-

[52] Beginning November 23, 1966 with a request for $1.1 million, seven more requests totaling $11 million were submitted to the railroad, $9.4 million of which was granted before it became apparent Strick was becoming much more of a cash drain than had been anticipated. On May 26, 1967, W. R. Grant, V. Pres. Finance, NYC, wrote to Sol Katz, President of Strick that such requests would no longer be granted by the railroad, explaining that (a) worthy projects of the railroad were being turned down in the interest of conserving cash; (b) 2,000 people had been released from the Central's payroll; (c) Strick had given no indications that it was going to request more funds than in their original proposition to the railroad, and (d) the railroad's cash had dropped $15 million in the past few months,$ 9 million of which had been advanced to Strick. See also letter dated May 25, 1967 from W. R. Grant to M. Bachman, V. Pres. Finance, Strick Corp. to the effect that with Strick sales volume down, an increase in which had been the basis for the advances commitment by the railroad, he could no longer justify additional advances. Appendix D, Exhibit 30, p. 541.

[53] See letter dated May 6, 1969 from A. E. Perlman to P. M. Shoemaker, Appendix D, Exhibit 31, p. 544.

[54] Acquisition of Kayser-Roth would have been accomplished by the issuance of approximately $231 million of two classes of Pennsylvania Co. cumulative preferred stock, the only cash outflow to have been cash dividends paid on these shares ($1.05 million annually) to be of course offset by cash dividends received from the acquired company.

troleum Corp.), consummated in February, 1970 not by the railroad itself, but by the Penn Central Company, established in 1969 as the holding company vehicle through which the merged company would pursue its diversification efforts.[55] Acquisition of Southwestern appears to have been made in an effort to integrate the railroad's Buckeye Pipe Line Co. subsidiary [56] and make its operations more profitable, as well as to gain the additional consolidated income of Southwestern and its subsidiary.

Financial Results of Diversification Program

The actual financial results of the railroad (and its predecessor companies) diversification programs in terms of reportable income and rate of return on investment are shown in the following tables. Care must be exercised in making definitive conclusions based on the data presented therein, however, since the front-ending of profits by the real estate subsidiaries significantly overstated reported net income, especially during 1968–1970.

SUMMARY OF EARNINGS OF SELECTED NONRAIL ACQUISITIONS

	Average investment		Plus dividends/interest paid on equity/debt securities used in purchase price			Percentage return reported only		Percentage return
			Total	Average	Percent	Total	Average	
PENNSYLVANIA RR. (1964–67)								
Buckeye	$100,671,478	(3.44)	$32,561,039	$9,451,998	9.4	$43,887,916	$12,732,202	12.6
Great Southwest Corp	20,360,928	(3.523)				8,062,432	2,288,511	11.2
Arvida Corp	22,446,784	(2.436)	936,327	384,371	1.7	1,093,645	448,951	2.0
Macco Realty	40,516,391	(2.386)				12,605,373	5,283,056	13.0
Total average annual investment	183,995,581			17,407,936	9.5		20,752,720	11.3
Total investment (end of 1967)	197,977,432		54,165,171			65,649,356		
N.Y.C. (1966–67)								
Strick	15,000,000	(1.173)				3,263,391	2,782,014	18.6
P.C.T.C. (and Penn Central Co.) 1968–69								
Buckeye	100,671,478		18,445,128	9,222,564	9.2	24,973,874	12,486,937	12.4
GSC [1]	59,188,677					43,742,637	21,871,319	37.0
Arvida	24,359,758		1,736,452	868,226	3.5	2,194,243	1,097,122	4.5
Macco Realty (1968 only)	40,563,039					20,994,190		51.8
Strick [2] (1968 only)	15,000,000					2,341,025		15.6
Total average investment	212,001,427			44,129,717	20.8		47,622,986	22.5
Total Investment (end of 1969)	220,569,432		87,259,432			94,245,969		
TOTALS (1964–69)								
Average annual investment	184,122,987			27,121,304	14.7		30,731,484	16.7
Total investment (end of 1969) [3]	220,569,432		144,687,877			163,158,716		
P.C.T.C. (and Penn Central Co.) 1970								
Buckeye	100,671,478		8,513,537		8.5	10,145,689		10.1
GSC	95,538,196					(131,984,808)		(138.2)
Arvida	24,359,758					63,649		(.003)
Southwestern Oil Refining Co	26.198,000		336,688			[4] 2,563,000		[4] 10.4
TOTALS (1964–70)								
Average Annual Investment	204,170,355			3,618,207	1.8		6,991,153	3.4
Total investment (end of 1970) [3]	274,464,432		20,943,577			41,383,256		

[1] Includes Macco Realty Co. 1969–70.
[2] Sold in December, 1968.
[3] Excludes results of Madison Square Garden (investment of $27,697,000 or 23 percent of total outstanding equity) which were not consolidated with those of parent company. (Earnings, however, for Madison Square Garden for the fiscal year ending May 31 were $1,081,000 for 1968 and $400,000 for 1970 with a loss of $1,234,000 for 1969.)
[4] Not consolidated with earnings of parent company (Penn Central Co.)

[55] See p. 426 herein for a more detailed discussion of the reasons for formation of the holding company.

[56] One of the original reasons Buckeye Pipe Line was available for acquisition was that it was one of the few pipeline companies not owned by a major oil producer.

PERCENTAGE RETURN ON TOTAL INVESTMENT BY RAILROAD (AS DETERMINED BY REPORTED EARNINGS OF SELECTED NONRAIL ACQUISITIONS)

Acquired company and year	Gross investment	Total reported earnings	Less dividends[1]	Net	Percentage investment return[2]
Buckeye Pipeline Co. (100 percent) [purchased July 24, 1964]:					
1964	$100, 671, 478	$7, 055, 850	$1, 529, 785	$5, 526, 065	10.6
1965	100, 671, 478	11, 227, 550	3, 267, 542	7, 960, 008	7.9
1966	100, 671, 478	12, 425, 130	3, 264, 778	9, 160, 352	9.1
1967	100, 671, 478	13, 179, 386	3, 264, 779	9, 914, 607	9.8
1968	100, 671, 478	13, 322, 756	3, 264, 441	10, 058, 315	10.
1969	100, 671, 478	11, 651, 118	3, 264, 305	8, 386, 813	8.3
1970	100, 671, 478	10, 145, 689	1, 632, 152	8, 513, 537	8.5
Total		79, 007, 479	19, 487, 882	59, 519, 697	
Average gross investment	100, 671, 478				
Average annual earnings (6.447 years)				[3] 9, 232, 154	9.2
Great Southwest Corp. [controlling interest purchased June 24, 1964]:					
1964	15, 272, 240	501, 387			6.4
1965	21, 405, 157	1, 520, 005			7.1
1966	22, 383, 157	2, 268, 453			10.1
1967	22, 383, 157	3, 772, 587			16.9
1968	22, 829, 157	9, 000, 887			35
1969	95, 538, 196	[4] 34, 741, 750			36.4
1970	95, 538, 196	[4] (131, 984, 808)			−(138.2)
Average gross investment	42, 192, 751				
Average annual loss (6.523 years)				(12, 381, 066)	−(29.3)
Arvida Corp. (59 percent) [controlling interest purchased July 26, 1965]:					
1965	18, 620, 837	(144, 810)		(144, 810)	−(1.8)
1966	24, 359, 758	613, 486		613, 486	2.5
1967		624, 969	157, 318	467, 651	1.9
1968		1, 426, 806	215, 084	1, 211, 722	5
1969		767, 437	242, 707	524, 730	2.2
1970		63, 649	0	63, 649	.003
Total		3, 351. 537	615, 109	2, 736, 428	
Average annual investment	23, 404, 771				
Average annual earnings (5,436 years)				503, 390	2.2
Macco Realty Corp. (99 percent) controlling interest purchased August 13, 1965], and Macco Development Corp. (80 percent).[5]:					
1965	40, 433, 094	453, 532			2.9
1966	40, 563, 039	4, 414, 829			10.9
1967	40, 563, 039	7, 737, 012			18.1
1968	40, 563, 039	20, 994, 190			51.8
Total		33, 599, 563			
Average annual investment	40, 530, 553				
Average annual earnings (3.386 years)				9, 923, 114	24.5
Strick Holding Corp. (100 percent purchased, Nov. 1, 1966):					
1966	15, 000, 000	886, 880			34.2
1967	15, 000, 000	2, 376, 511			15.8
1968	15, 000, 000	2, 341, 025			15.6
Total		5, 604, 416			
Average annual investment	15, 000, 000				
Average annual earnings (2.713 years)				2, 579, 115	17.2
Madison Square Garden Corp. (23 percent acquired by PCTC December 1968):					
1968	27, 697, 000	[6]			
1969	27, 697, 000	[6]			
1970	27, 697, 000	[6]			
Average annual investment	27, 697, 000				
Southwestern Oil Refining Co. [and wholly-owned subsidiary Royal Petroleum Corp.] (100 percent acquired by Penn Central Co. in February 1970): [7] 1970	26, 198, 000	[8] 2,563,000	336, 688	[8] 2, 236, 312	9.2

[1] Less dividends paid on equity securities used in purchase price.

[2] Percentage investment return (on average annual basis since date of acquisition).

[3] Includes cash used in purchase price, market value (at date of preliminary agreement) of debt or equity securities issued as part of purchase price, commissions and fees paid on acquisition, plus additional equity investment, if any.

[4] Includes Macco Realty Corp. which was merged into Great Southwest Corp. on February 26, 1969.

[5] 80 percent owned PRR subsidiary incorporated August 1965 specifically to make Macco Realty Corp. acquisition. Assets consisted solely of stock (99 percent) of Macco Realty. Macco Realty Corp. later merged into Macco Development Corp. and the name of the company changed to Macco Realty Co. Operating results of Macco Development in 1965 and 1966 included with those of Macco Realty Corp.

[6] Earnings not consolidated with those of parent company (less than controlling interest owned). However, earnings for Madison Square Garden for fiscal year ended May 31 were $1,081,000 for 1968 and $400,000 for 1970 with a loss of $1,249,000 for 1969.

[7] Transaction later rescinded pursuant to settlement agreement entered into February 25, 1971 by both parties to Former Shareholders of Southwest Oil Refining Co. and Royal Petroleum Co. versus Penn Central Co. and approved by the court and entered for judgment on April 9, 1971 in Civil Action 70–C–135, U.S. Federal District Court (S.D. Tex., Corpus Christi Division).

[8] Earnings not consolidated with those of parent company (Penn Central Co.) for year.

As shown more particularly by the above tables, the results of the diversification efforts by the PCTC and its predecessor companies were, briefly, as follows. From 1964–1967, the PRR realized an average 11.3 percent return ($20.75

million in average total reportable earnings) on an average total annual investment of $183.99 million. The NYC, on the other hand realized an 18.6 percent average return ($2.78 million average annual earnings) on its Strick investment ($15 million) in 1966–67. The Penn Central Transportation Company realized a 22.5 percent average return ($30,731,484 in average annual reportable earnings) on its inherited, and partially supplemented investment of $184.12 million in the same nonrail acquisitions in 1968–1969. Overall, the combined results in the period 1964–1969 reflected an average return of 16.7 percent ($30,731,494 in average total annual reportable earnings) on an average total annual investment of $184.12 million.

Total reported earnings from the nonrail acquisition earnings for the same period amounted to $163.16 million, $65.65 million of this amount was earned during 1965–67 by the nonrail acquisitions of the PRR, $3.26 million by Strick for the NYC in 1966–67 and the balance of $94.25 million while under merged company ownership in 1968–69.

Quite obviously, the railroads were reasonably successful, in the 1964–1969 pre-bankruptcy period, from the standpoint of reported income, in obtaining a good return on their investment.[57] However, while the program objective of generating additional earnings to offset rail operations was successful it also had the undesirable effect of covering over the failing rail condition.[58]

Total Diversification Investment Relative to Reinvestment in Rail Plant

The following tables place into perspective the relative amounts expended by the railroad on (a) its diversification program and (b) its own rail plant:

TOTAL CASH INVESTMENT IN DIVERSIFICATION PROGRAM RELATIVE TO TOTAL REINVESTMENT IN PLANT (1963–67), P.R.R. AND N.Y.C.

	Total cash investment in diversification program [1]	Total reinvestment in plant [2]	Percent
P.R.R.			
Year:			
1963	$28,303,000	$205,384,912	13.8
1964	19,619,768	268,681,436	7.3
1965	56,083,391	366,014,140	15.3
1966	19,935,342	342,400,175	5.8
1967	15,558,759	260,095,335	6.
Total	139,500,260	1,442,575,998	9.7
N.Y.C.			
Year:			
1966	2,997,000	230,235,645	1.3
1967	21,440,000	200,468,533	10.7
Total	24,437,000	430,704,178	5.7

[1] Includes total cash used in purchase price; commissions and fees paid in connection with acquisition; dividends/interest paid on equity/debt securities issued as part of acquisition purchase price; net increases (decreases) in loans and advances outstanding at end of calendar year.

[2] Includes all capital and maintenance (road and equipment) expenditures.

[57] The net effective earnings column shown in the tables (netting out dividends/interest paid on equity/debt securities issued as part of the purchase price) is also of interest and of course reflects a lower net return. Only in the case of Arvida however would there be any effect on reported earnings (interest paid on debt securities of course being a business expense deducted in arriving at net income while preferred dividends are not).

[58] In late 1968, the decision was made by the company to place primary emphasis in earnings reports and financial press releases on consolidated results, stressing the fact that the company was diversified in scope of operations. (See S. T. Saunders' Board Memorandum dated April 23, 1969. Appendix D, Exhibit 32, p. 545.) All reports to the company Board of Directors also gave primarily emphasis to consolidated results. Regardless of rationale employed, the move was quite obviously another reflecting management's own concern with the financial performance of its rail operations. Moreover, besides seeking to acquire earnings through diversification the PRR in its quest for additional reportable earnings earlier in 1965 had extended its consolidated financial statements to include all majority-owned subsidiaries which it controlled. The exchange resulted in the inclusion, for statement purposes, of the income of all companies in which the PRR interest exceeded 50 percent. (Inclusion for tax reporting purposes of course requires at least an 80 percent interest). The major change this brought about in the reporting of the PRR consolidated income statement was the including of the PRR stockholder share of undistributed earnings of majority owned and controlled companies which were formerly shown, in part, in the notes to the financial statements but not in the consolidated income and balance sheet figures. See memoranda dated February 15, 1965, and February 26, 1965, between D. C. Bevan and S. T. Saunders, Appendix D. Exhibit 33, p. 550.

TOTAL CASH INVESTMENT IN DIVERSIFICATION PROGRAM RELATIVE TO TOTAL REINVESTMENT IN PLANT (1963-69), P.C.T.C. AND PREDECESSOR COMPANIES

Year	Total cash investment in diversification program [1]	Total reinvestment in plant [2]	Percent
1963	$28, 303, 000	$374, 412, 811	7.6
1964	19, 619, 768	476, 426, 014	4.1
1965	56, 083, 391	572, 514, 308	9.8
1966	22, 932, 342	572, 635, 820	4.0
1967	36, 998, 759	460, 563, 868	8.0
1968	22, 089, 381	449, 830, 258	4.9
1969	15, 207, 012	530, 049, 112	2.0
Total	201, 233, 663	3, 436, 432, 191	5.7
(1970)	1, 968, 820	516, 809, 429	.4

[1] Includes total cash used in purchase price; commissions and fees paid in connection with acquisition; dividends/interest paid on equity/debt securities issued as part of acquisition purchase price; net increases (decreases) in loans and advances outstanding at end of calendar year.
[2] Includes all capital and maintenance (road and equipment) expenditures.

CAPITAL EXPENDITURES

PENNSYLVANIA AND NEW YORK CENTRAL; 1946-67 [1]

[In millions of dollars]

Year	Pennsylvania	New York Central	Year	Pennsylvania	New York Central
1967 [2]	114.7	69.1	1956	92.4	79.3
1966	197.4	95.9	1955	69.0	39.6
1965	244.2	107.9	1954	41.0	39.1
1964	100.8	81.3	1953	80.5	88.0
1963	82.4	39.5	1952	123.3	148.4
1962	63.0	40.2	1951	215.6	125.7
1961	60.9	32.0	1950	87.8	70.6
1960	155.9	39.6	1949	105.8	100.5
1959	125.2	28.7	1948	106.3	90.2
1958	53.8	18.2	1947	52.7	48.4
1957	97.7	114.2	1946	33.7	41.2

[1] Includes leased lines.
[2] Excludes expenditures on leased equipment.

Source: ICC Form A, Railroad Annual Reports.

TOTAL MAINTENANCE EXPENDITURES; SELECTED RAILROADS; 1958-70 [1]

[In millions of dollars]

	Penn Central [1]	Pennsylvania	New York Central	Baltimore & Ohio	Chesapeake & Ohio	Southern
1970	651.2			138.2	139.5	133.6
1969	473.3			126.8	133.4	117.6
1968	427.6			123.5	122.1	102.0
1967	421.0	243.5	177.5	114.0	118.5	86.8
1966	421.8	239.3	182.5	114.3	115.4	87.2
1965	416.1	237.1	179.0	108.2	111.2	87.8
1964	418.4	239.1	179.3	107.2	113.7	87.1
1963	420.9	236.0	184.9	112.4	131.3	80.9
1962	435.2	247.5	187.7	73.6	108.0	79.4
1961	418.5	232.7	185.8	114.8	100.6	78.0
1960	449.0	246.6	202.4	114.5	105.6	75.9
1959	465.5	262.6	202.9	117.0	101.4	77.2
1958	437.2	252.0	185.2	107.6	97.2	81.4

[1] Pro forma combination of Pennsylvania and New York Central; 1958-67.

Source: Moody's Transportation Manual.

TOTAL REINVESTMENT IN FLANT, 1960-69—(CAPITAL[1] AND MAINTENANCE—ROAD AND EQUIPMENT—EXPENDITURES)

	N.Y.C.		P.R.R.		P.C.T.C.	
Year	Amount	Percent increase (decrease)	Amount	Percent increase (decrease)	Amount	Percent increase (decrease)
1960	190, 175, 444		253, 469, 515		443, 644, 959	
1961	173, 500, 982	(8.8)	219, 711, 508	(13.7)	393, 212, 490	(11.4)
1962	171, 923, 673	(.9)	233, 637, 690	12.9	405, 561, 363	3.1
1963	169, 027, 899	(1.0)	205, 384, 912	(12.1)	374, 412, 811	(7.7)
1964	207, 744, 578	22.9	268, 681, 436	23.6	476, 426, 014	27.2
1965	206, 500, 168	(.6)	366, 014, 140	36.6	572, 514, 308	20.2
1966	230, 235, 645	11.5	342, 400, 175	(6.4)	572, 635, 820	0.02
1967	200, 468, 533	(12.9)	260, 095, 335	(24.0)	460, 563, 868	(19.6)
1960–63	704, 627, 998		912, 203, 625		1, 616, 831, 623	
1964–67	844, 948, 924	19.9	1, 237, 191, 086	35.6	2, 082, 140, 010	(28.8)
1968					449, 830, 258	(2.5)
1969					530, 049, 112	20.1
1970					516, 809, 429	(2.5)

[1] Includes new equipment purchases, reconstruction of old equipment expenditures and capital improvement and betterments.

Source: Form A Annual Reports submitted by N.Y.C. and P.R.R. to ICC for calendar years 1960–1967 and P.C.T.C. for calendar years 1968–1970.

As can be seen from the above tables the amounts expended on the diversification program of the railroad(s) were small when compared to the cash funds which the companies continued to reinvest in the rail plant. On a combined basis (PRR and NYC) the total amount invested in non-rail acquisitions averaged but 5.7 percent of the amount expended on capital and maintenance (road and equipment) expenses over the period 1963–1969. The maximum spent in one year, $56.08 million in 1965, amounted to only 9.8 percent of total capital and maintenance expenditures by the combined railroads for the year. Looking at the predecessor companies individually, the 1965 figure still amounted to but 15.3 percent of the total funds employed by the PRR for capital and maintenance projects for the railroad itself. Moreover, that same year, the PRR increased its capital expenditures 126 percent from approximately $80 million to $180 million. Furthermore, while the PRR was in the midst of its diversification program in 1964–1967, it was increasing its total rail capital expenditures 201 percent from $162.3 million to $488 million in comparison to the four year period 1960–1963.

The merged company itself expended a much smaller part of its funds on diversification-related costs in comparison to total amounts spent on total capital and maintenance expenditures than did its predecessors (4.9 percent in 1968 and only 2 percent in 1969). Furthermore total amounts reinvested in the rail plant rose 20.1 percent.

It would be impossible at this date to measure the return achieved on the total sums reinvested in the railroad itself other than to note that there seemed to be little noticeable effect on rail operating results—which continued to decline at nearly all times during the period. On the other hand, the amounts invested in the diversification program achieved far greater reported returns in the 1963-1969 pre-bankruptcy period, accounting for substantial parts of reported consolidated income during that time.

TOTAL INCOME FROM DIVERSIFICATION PROGRAM RELATIVE TO RAILROAD INCOME

The substantial effect which earnings from non-rail acquisitions had upon consolidated income for the railroad(s) for period 1964–1969 is demonstrated in the following table:

EARNINGS CONTRIBUTED BY SELECTED ACQUIRED NONRAIL SUBSIDIARIES TO CONSOLIDATED EARNINGS OF RAILROAD (1964–69)

Year and company	Gross revenues		Net earnings	Contribution to consolidated earnings (per share)	
1964:					
Buckeye Pipe Line (100 percent)	$29,964,347		([1,2]) $7,055,850	$0.51	
Great Southwest Corp. (63 percent)	([1,2]) 7,725,591		([2,3]) 501,387	.04	
Total (Percent of consolidated figure)	37,689,938	(4%)	7,556,237	.55	(13%)
(PRR)	1,002,717,519		60,097,048	4.37	
1965:					
Buckeye Pipe Line (100 percent)	29,716,357		11,227,550	.81	
Great Southwest Corp. (73 percent)	17,741,929		1,520,005	.11	
Arvida Corp. (51 percent)	([2,4]) 5,037,612		([2,4]) (144,810)	(.01)	
Macco Realty Corp. (98 percent)	([4,5]) 5,513,882		([2,5]) 737,996	.05	
Macco Development Corp. (80 percent)			([6]) (284,464)	(.02)	
Total (Percent of consolidated figure)	58,009,780	(5%)	13,056,277	.94	(19%)
(PRR)	1,072,530,439		70,113,462	5.06	
1966:					
Buckeye Pipe Line (100 percent)	31,661,031		12,425,130	.89	
Great Southwest Corp. (80 percent)	21,332,303		2,268,453	.16	
Arvida Corp. (59 percent)	9,748,884		613,486	.04	
Macco Realty Corp. (99 percent)	23,250,879		4,414,829	.31	
[Macco Development Corp. (80 percent)]			([7]) 505,441	.04	
Total (Percent of consolidated figure)	85,993,097	(7%)	20,227,339	1.44	(22%)
(PPP)	1,139,976,008		90,292,727	6.49	
Strick Holding Co. [10C percent] (Percent of consol. figure)	90,957,406	(7%)	([8]) 886,880	.13	(1%)
(NYC)	817,977,908		60,303,348	8.75	
1967:					
Buckeye Pipe Line (100 percent)	32,156,370		13,179,386	.94	
Great Southwest Corp. (80 percent)	29,866,988		3,772,587	.27	
Arvida Corp. (59 percent)	11,035,989		624,969	.04	
Macco Realty Corp. (99 percent)	36,187,377		7,737,012	.53	
Total (Percent of consolidated figure)	109,246,724	(9%)	25,303,954	1.78	(41%)
(PRR)	1,163,197,264		([9]) 60,344,240	4.31	
Strick Holding Co. [1C0 percent] (Percent of consol. figure)	68,539,303	(8%)	2,376,511	.34	(22%)
(NYC)	819,980,411		([10]) 10,995,654	1.59	
1968:					
Buckeye Pipe Line (100 percent)	35,748,000		13,322,756	.55	
Great Southwest Corp. (80 percent)	110,374,000		9,000,887	.37	
Arvida Corp. (59 percent)	13,649,000		1,426,806	.05	
Macco Realty Corp. (99 percent)	84,535,961		20,994,190	.87	
Strick Holding Co.[11]			2,341,025	.10	
Total (Percent of consolidated figure)	244,306,961	(11%)	47,085,664	1.94	(52%)
(PCTC)	2,125,042,000		9C,273,000	3.74	
1969:					
Buckeye Pipe Line (100 percent)	37,645,000		11,651,118	.48	
Great Southwest Corp.[12] (90 percent)	144,238,000		34,741,750	1.44	
Arvida Corp. (59 percent)	11,488,480		767,437	.03	
[Strick Holding Co.]	0		([13]) (787,292)	(.03)	
Total (Percent of consolidated figure)	193,371,480	(9%)	46,373,013	1.98	
Consolidated total	2,252,726,000		([14]) (121,612,000)	−(5.44)	
1970:					
Buckeye Pipe Line (100 percent)	([14])		10,145,689		
Great Southwest Corp. (90 percent)	([14])		(131,984,808)		
Arvida Corp. (59 percent)	([14])		63,649		
Total	([14])		([15]) (121,775,470)		
Consolidated total	([14])		([14])		

[1] Purchased July 24, 1964.
[2] Includes only appropriate portion after date of acquisition.
[3] Purchased June 24, 1964.
[4] Purchased July 26, 1965.
[5] Controlling interest purchased Aug. 13, 1965.
[6] 80 percent owned PRR subsidiary incorporated specifically to make Macco Realty Corp. acquisition in 1965 and which owned 98 percent of the latter. Assets consisted solely of equity securities in Macco Realty Corp. Initial losses attributable to incorporation expenses.
[7] See footnote 6 above. Macco Development Corp. was merged into Macco Realty Corp. in 1967.
[8] Purchased Nov. 1, 1966.
[9] Before extraordinary charge of $149,525,000 for costs and losses incurred upon merger.
[10] Before extraordinary charges of $129,045,376, including $125,896,985 for costs and losses incurred upon merger.
[11] The principal operating companies of Strick Holding Co.: Strick Corp. and Transport Pool, Inc., were sold in December 1968 for $24,437,000 (including $15,000,000 cash and $9,437,000 principal amount subordinated note).
[12] Includes Macco Realty Corp., merged into a wholly-owned subsidary of Great Southwest Corp. in March 1969 and accounted for on a pooling of interests basis.
[13] State taxes payable on sale of Strick Corp. and Transport Pool, Inc. (see footnote 11 above) and paid by PCTC. Obligation originally that of Strick Holding Co. which was merged into PCTC in 1969.
[14] Consolidated report never issued, figures unavailable.
[15] Loss.

As can be seen from the above table, by 1967, income from its non-rail acquisitions amounted to 41 percent of the consolidated earnings of the PRR. Moreover, that same year, Strick alone accounted for 22 percent of the reported consolidated income for the NYC. In 1968 income from these subsidiaries amounted to over half (52 percent) of the PCTC consolidated income (or $1.94 per share of the reported $3.74). In 1969, despite the sale of Strick the year before, income from the remaining non-rail acquisitions amounted to $1.98 per share in comparison to a consolidated loss of $5.44 per share. The importance of the railroad's diversification efforts to its reported consolidated earnings position is thus apparent.

Diversification as a Policy

In theory diversification is, briefly, viewed by its advocates as an effective carrier self-help tool by which management through investing in non-rail businesses having a greater rate of return and consolidation of these earnings with those of the parent company, can bring about an overall improvement of earnings (as well as, with the proper investment, cash flow also). In addition to providing earnings the carrier would not otherwise possess, the acquisition of more readily capitalizable assets further improves the carrier's access to capital markets in order to finance rail projects, while at the same time serving the stockholder interests by helping to prop up unsatisfactory carrier income. Proponents also argue that through diversification a railroad can add growth assets with potential for even increased future earnings to the railroad which can be of further benefit by not only providing income to deficit or marginal situations, but by offsetting declines of otherwise healthy rail operations resulting from cyclical downturns in business or inflationary pressures.

For railroads with declining or marginal rail operations diversification has been viewed as a virtual necessity in maintaining viability. (Several, including the Missouri, Kansas and Texas Railway Co. and the Chicago and Northwestern, have resorted to wide use of acquisition programs in an attempt to accomplish this objective.) For some carriers, diversification has been seen by the management as not simply a means of partial assistance, but the only alternative to bankruptcy, and if viewed from a survival standpoint, its employment must certainly be accorded serious consideration.[59]

An evaluation of diversification as an effective policy in the PCTC case is inconclusive from an overall standpoint because of the poor application of the theory to the principal investments (i.e. real estate development, EJA). However, in the period 1964–1969, prior to the bankruptcy, such investments appeared to be of some value to the railroad(s), achieving a substantial return and a modest return in terms of cash.

THE SPECIFIC PROGRAM—COSTS AND BENEFITS

The reported earnings benefits achieved in 1964–1969 have already been described. There were of course other related effects of the diversification program on the railroad which are set forth at this point:

Effect on cash shortage

The first of these is the effect that the acquisition activities had upon the railroad(s)' already existent cash shortage position. Although there was an

[59] Detractors from the diversification theory argue principally that (a) railroads with earnings obtained from "conglomerating" will avoid making decisions necessary to resolve the existing national rail service problems if such a decision entails a compromise to their own competitive (and therefore earnings) position (e.g. the freight car supply situation, resolution of a national merger pattern, etc.) and (b) that even if earnings are generated, non-rail investment projects with a greater rate of return will be given priority over the necessary, but lower return, rail projects. See copy of speech given by Jervis Langdon, Chairman and President, Chicago, Rock Island and Pacific Railroad Co., to the Minneapolis Traffic Club on April 10, 1969, and letter dated 5/26/69 by J. Langdon to S. T. Saunders at Appendix D, Exhibit 34, p. 551. Advocates of diversification deny these propositions responding that (a) it is not necessary to cling to poverty as the only stimulus to solving rail problems and (b) many individual rail projects offer far greater returns from non-rail investments. Moreover, they assert that there is ample incentive to the good earning railroads to protect their earnings—and considerable plant investment. To the poorer earning companies, as stated above, they allege it may well be the only alternative for survival. (See letter dated 5/19/69 from W. B. Johnson, Chairman and Chief Executive Officer, Illinois Central Railroad to T. M. Goodfellow, President, Association of American Railroads. (See also memo dated 7/22/69 from W. R. Gerstnecker, Vice President and Teasurer, PCTC to Basil Cole, Vice President Administration, PCTC—Appendix D, Exhibit 35, p. 553.)

unquestionable need for reported earnings, the necessity of maintaining cash at a level in order to meet normal operating expenses (which became critical in 1966–1967 for the PRR,[60] and reached the same stage for the PCTC soon after merger) [61] was also of importance. This factor, however, with the sole exception of the Buckeye acquisition, whose dividends provided a reasonable [62] return, and which more importantly did not require additional financing by the railroad, appears to have been virtually ignored in its diversification objectives.

The following tables demonstrate the net cash effect on the railroad(s) as the result of diversification activities:

SUMMARY OF CASH RETURN ON SELECTED NONRAIL INVESTMENTS

	Average cash investment	Total/average	Cash return	Percen
P.R.R. (1963–1967):				
Buckeye Pipe Line	$37,188,503	Total	$20,915,000	
	(3.447)	Average	6,067,595	16.3
GSC	22,989,152	Total	285,614	
	(3.523)	Average	81,071	.4
Arvida	13,675,224		0	0
	(3.436)			
Macco Realty	44,955,103	Total	1,479,357	
	(2.386)	Average	619,552	1.2
Total average annual investment	118,807,982	Average annual cash return	6,768,218	5.7
Cash investment (at end of 1967)	133,271,968	Total cash return	22,679,671	
N.Y.C. (1966): Strick	21,217,000	Total	1,223,241	4.9
	(1.173)	Average	1,042,832	
P.C.T.C. (and Penn Central Co.) (1968–69):				
Buckeve Pipe Line	46,982,956	Total	12,600,000	
		Average	6,300,000	12.6
GSC	51,240,917	Total	1,533,253	
		Average	766,627	1.5
Arvida	20,995,139		0	0
Macco Realty (1968 only)	53,537,589		570,892	1.1
Strick (1968 only)	24,437,000		689,902	2.8
			[1] (5,489,902)	(22.9)
Total average annual investment	158,306,307	Average annual cash return	7,697,024	4.9
			[1] (9,639,224)	[1] (6.1)
Total cash investment (at end of 1969)	119,219,012	Total cash return	15,394,047	
			[1] (19,278,448)	
P.C.T.C. (and Penn Central Co.) (1970)				
Buckeye Pipe Line	50,247,260		3,100,000	6.2
GSC	93,009,711		0	0
Arvida	22,566,492		0	0
Madison Square Garden Corp	6,697,000		0	0
Southwestern Oil Refining Co. (acquired by Penn Central Co.).	336,688		400,000	118.9
Totals (1963–70):				
Average annual cash investment	138,363,992	Average annual cash return	7,452,569	5.4
Total cash investment (at end of 1970)	172,520,463	Total cash return	[1] 47,328,773	

[1] Includes liquidating dividend of $4,800,000 paid before merger of Strick Holding Co. into P.C.T.C. in December 1969.

PERCENTAGE CASH RETURN ON SELECTED NONRAIL INVESTMENTS

Company acquired, year	Gross cash investment [1]	Total cash dividends received	Total interest payments received	Total cash payments received (paid out) under tax allocation agreement	Total cash payments received (dividends and interest plus tax allocation payments)	Percentage return on investment (on annual basis since date of acquisition)
Buckeye Pipe Line Co. (100 percent purchased July 24, 1964):						
1964	$32,289,263	$2,850,000		(2)	$2,850,000	19.0
1965	35,556,805	5,965,000			5,965,000	16.7
1966	38,821,583	5,800,000			5,800,000	14.8
1967	42,086,362	6,300,000			6,300,000	15.9
1968	45,350,803	6,300,000			6,300,000	13.9
1969	48,615,108	6,300,000			6,300,000	13.0
1970	50,247,260	3,100,000			3,100,000	6.2
Average annual investment (cash)	41,852,455			Total	36,615,000	
				Average annual payments (cash)(6.447 years).	5,679,383	13.6

[60] See memoranda dated 10/25/66 and 11/8/67 from D. C. Bevan to S. T. Saunders, Appendix D, Exhibit 36, p. 554.

[61] See memorandum dated 8/30/68 from D. C. Bevan to S. T. Saunders, Appendix D, Exhibit 37, p. 560.

[62] However, the effect of these dividends was considerably reduced (well over half) after payment of dividends on preferred stock used in making the acquisition. (See table at p. 410 above.)

PERCENTAGE CASH RETURN ON SELECTED NONRAIL INVESTMENTS—Continued

Company acquired, year	Gross cash investment [1]	Total cash dividends received	Total interest payments received	Total cash payments received (paid out) under tax allocation agreement	Total cash payments received (dividends and interest plus tax allocation payments)	Percentage return on investment (on annual basis since date of acquisition)
Great Southwest Corp. (82 percent) (controlling interest purchased June 24, 1964; additional equity interest acquired through Dec. 31, 1969:)						
1964	15,272,240	0	0	0	0	0
1965	21,407,122	0	0	0	0	0
1966	25,888,122	0	8,450	0	8,450	.0003
1967	29,388,122	219,781	57,383	0	277,164	.009
1968	39,472,122	1,056,589	199,500	0	1,256,089	3.2
1969 [3]	93,009,711	2,990,071	195,000	0	3,185,071	3.4
1970	93,009,711	0	0	[4] 0	0	0
				Total	4,726,774	
Average annual investment (cash)	45,375,306			Average annual payments (cash) (6.523 years)	726,165	1.6
Arvida Corp. (59 percent) (controlling interest purchased July 26, 1965:)						
1965	5,214,750	0		([5])	0	0
1966	15,502,527	0			0	0
1967	15,659,845	0			0	0
1968	19,232,785	0			0	0
1969	22,566,492	0			0	0
1970	22,566,492	0			0	0
Average annual investment (cash)	15,138,982			Average annual payment (cash) (5.436 years).	0	0
Macco Realty Co. (99 percent) (interest purchased August 13, 1965 in conjunction with tender offer of Sept. 13, 1965:) [6]						
1965	40,007,644	0	495,361	([2])	495,361	1.2
1966	40,137,589	0	309,678		309,678	.7
1967	46,137,589	0	103,426		103,426	.3
1968	53,537,589	0	570,892		570,892	1.1
				Total	1,479,357	
Average annual investment (cash)	44,955,103			Average annual payment (cash) (3.386 years).	437,707	1.0
Strick Holding Co. (100 percent (purchased Nov. 1, 1966 by New York Central Railroad Co.)						
1966	17,997,000	0	0	0	0	
1967	24,437,000	0	533,339	0	533,339	
1968	24,437,000	0	689,902	0	689,902	
1969	([7])	4,800,000	0	(915,599)	3,884,401	
				Total	4,107,642	
Average annual investment (cash)	22,290,333			Average annual payment (cash) (3.173 years).	1,294,580	
Madison Square Garden Corp. (23 percent interest acquired in December 1968):						
1968	6,697,000	0	0	([5])	0	0
1969	6,697,000	0	0		0	0
1970	6,697,000	0	0		0	0
Average annual investment (cash)	6,697,000			Average annual payment (cash).	0	0
Southwest Oil Refining Co.: 1970	336,688	400,000	0	0	400,000	118.9

[1] Includes cash used in purchase price, interest (dividends) paid on debt or equity securities used in purchase price, cash fees paid in connection with acquisition and loans and advances to each subsidiary on a cumulative basis at the end of each calendar year.
[2] No tax allocation agreement between parent railroad and nonrail subsidiary.
[3] Includes Macco Realty Co. which was merged into Great Southwest Corp. on Feb. 26, 1969.
[4] Balance payable to Great Southwest Corp. from PCTC as of Dec. 31, 1970 was $2,152,875.
[5] Railroad ownership of subsidiary did not reach the 80 percent (of total voting stock outstanding) necessary in order to consolidate operating results for tax purposes.
[6] Merged into Great Southwest Corp. on Feb. 26, 1969.
[7] Principal operating companies of Strick Holding Co. (Strick Corp. and Transport Pool, Inc.) sold for $24,437,000 in December, 1968 and Strick Holding Co. merged into PCTC in December, 1969.

DIVIDENDS (INTEREST) PAID BY SELECTED ACQUIRED NONRAIL SUBSIDIARIES TO PENNSYLVANIA CO.[1] (1964–70)

Company making payment	1964	1965	1966	1967	1968	1969	1970	Total
Buckeye Pipe Line	$2,850,000	$5,965,000	$5,800,000	$6,300,000	$6,300,000	$6,300,000	$3,100,000	$36,615,000
Great Southwest Corp	0	0	0	219,781	1,056,589	2,990.071	0	4,266,441
			(8,450)	(57,383)	(199,500)	(195,000)		[2] (460,333)
Arvida Realty Co		0	0	0	0	0	0	0
Macco Realty Corp		(495,361)	(309,678)	(103,426)	(570,892)	(1,297,174)	0	[3] (2,776,531)
Strick Holding Co			0	(533,339)	(689,902)	0	0	(1,223,241)
Executive Jet Aviation, Inc.[4]		(118,000)	(370,000)	(136,000)	0	0	0	(624,000)
Dividends	2,850,000	5,965,000	5,800,000	6,519,781	7,356,589	9,290,071		40,881,441
Interest		613,361	688,128	830,148	1,460,294	1,492,174		5,084,105
Total	2,850,000	6,578,361	6,488,128	7,349,929	8,817,883	10,782,245	3,100,000	45,965,546

[1] Figures in parentheses indicate interest payments.

[2] $23,750 paid in cash, remainder of $436,583 in GSC common stock of equivalent market value.

[3] Payments made in cash 1965–68. $721,522 of amount due in 1969 paid by issuance of Great Southwest Corp. common stock of equivalent market value (after merger of Macco Realty Corp. into GSC on Feb. 26, 1969). Total cash payments on Macco originated obligations during 1965–70 amounted to $2,055,009.

[4] Investment in Executive Jet Aviation, Inc., principally in form of debt interest—and also class B nonvoting common stock (although amounting to over 57 percent of total equity outstanding).

Note: Unless otherwise indicated all dividend and interest payments were made in cash.

Source: Tabular information submitted by railroad pursuant to request of Committee's special staff.

DIVIDENDS (INTEREST) PAID BY SELECTED ACQUIRED NONRAIL SUBSIDIARIES TO PENN CENTRAL TRANSPORTATION CO. (AND/OR PREDECESSOR COMPANIES) YEARS 1964–70

Company making payment	1964	1965	1966	1967	1968	1969	1970	Total
Pennsylvania Co	20,000,000	$23,000,000	$24,000,000	$25,500,000	$24,000,000	$24,000,000	0	$140,500,000
Strick Holding Co	0	0	0	0	0	4,800,000	0	4,800,000
Dividends	20,000,000	23,000,000	24,000,000	25,500,000	24,000,000	28,800,000	0	145,300,000
Interest	0	0	0	0	0	0	0	0

PENN CENTRAL TRANSPORTATION CO. (AND/OR PREDECESSOR COMPANIES)

ACCOUNTING FOR TAX ALLOCATION[1]

RECEIVABLE FROM (PAYABLE TO) SELECTED SUBSIDIARIES[2]

Date	Strick Corp.	Great Southwest Corp.
1967: Tax allocation (payable to)	$(915,599)	
December 31, 1967: Balance (payable to)	(915,599)	
1968: Tax allocation receivable from (payable to)	(13,401)	$2,574,000
December 31, 1968: Balance receivable from (payable to)	(929,000)	2,574,000
1969: Tax allocation receivable from	13,401	5,393,929
1969: Payments (received) made	[3] (915,599)	[4] (2,152,875)
December 31, 1969: Balance receivable from		5,815,054
1970: Tax allocation (payable to)		(7,967,929)
December 31, 1970: Balance (payable to)		(2,152,875)
Net cash realized (paid out)	(915,599)	0

[1] Both Strick Holding Co. and Great Southwest Coro. entered into an agreement with the parent railroad immediately after acquisition whereby the subsidiary agreed to reimburse it for 95 percent of the takes that would have been paid by the subsidiary had there been no consolidation of its income with that of the railroad. In the case of Strick there were also provisions whereby the parent railroad would pay it for use of certain Strick deductions and credits in the consolidated statement, and thus the amounts shown as payable to Strick. Great Southwest Corp. also claims that similar provisions applied to its agreement with P C.T C. and even though the latter's books reflect the above shown amount of $2,152,875 was oayable to Great Southwest Corp. as of Dec. 31, 1970, this amount is in dispute.

[2] Selected subsidiaries—Great Southwest Corp., Macco Corp., Arvida Corp., Buckeye Pipe Line Co., and Strick Holding Co. No agreement was entered into between the railroad and Buckeye Pipe Line Co. or Macco Realty Co. In addition, only 58 percent of Arvida Corp. is owned by the railroad and its income is therefore not consolidated for tax purposes with that of the parent company.

[3] On the date of Strick Holding Co.'s merger into Penn Central Transportation Co. in 1969, the amount of $915,599 was offset against receivable's due Penn Central Transportation Co. from Strick Holding Co.

[4] Amount was assigned to Pennsylvania Co. in 1969 for an advance receivable. Penn Central Transportation Co. received cash in the amount of $2,152,875 from Pennsylvania Co. in February 1970.

As shown above, a total of $196.5 million in cash was expended on diversification-related costs from 1963–1969 by the railroad(s)—with $139.5 million of that amount spent by the PRR. As has been commented upon earlier, however, although such expenditures were financed from working capital, approxi-

mately $69 million would have been replaced from proceeds of a sale of N&W stock in 1963 ($4 million) and the sale of the Long Island Rail Road Co., in 1966 ($65 million in cash).[63] Furthermore, 1968–1969 N&W common stock sale proceeds amounted to $33.1 million, replacing nearly all funds expended by the PCTC on diversification costs.

Making allowances for dividends and interest payments received from these subsidiaries (net loans and advances are included in the above cash loss figures) amounting to $47.32 million received over the same 1963–1969 period ($22.1 by the PRR, $24.6 by the PCTC and $0.5 by the NYC) the overall net cash loss is diminished to $46.26 [64] million. More specifically, net cash losses on an individual railroad basis were $47.4 million for the PRR,[65] and $19.1 million for the NYC—while a net cash gain of $24.7 million was realized for the merged company alone.

Other than cash used in the purchase price, the next largest drain was in the form of loans and advances to the acquired non-rail companies. Although the dividend paying performance of a company might not be considered of major importance in a growth oriented investment program such as that apparently undertaken by the railroad,[66] whether a company will have a continual need for external financing (as mentioned, a demonstrated characteristic of real estate development companies) would certainly be of importance to a cash short acquirer. The latter assumes, of course, that financing may have to be provided by the parent company—as happened with GSC and Macco Realty. A total of $23.8 million was advanced to the two companies by the end of the third quarter. 1969, and although the above table reflects repayment of the amount in the next quarter, such repayment was in the form of additional GSC common stock, not cash.[67] Moreover, total loans and advances to Executive Jet Aviation, Inc., a new company whose existence was dependent on external financing to fund heavy start-up costs (principally in the form of expensive jet aircraft equipment purchases), amounted to in excess of $21 million by the end of the first quarter, 1969 (on which $0.9 million was eventually realized by sale completed in January, 1972). Thus although reported earnings from the diversification program were satisfactory they effectively worked a distraction from the continued cash drain which the real estate development and EJA subsidiaries were having on the parent company. Such an undesired result might have been effectively avoided by a more appropriate selection of investment opportunities.

In this connection it might be noted that an expected source of cash funds from the non-rail acquisitions, tax allocation payments, never developed, and in fact worked as a further drain. (See table *supra* at p. 416). These agreements between parent and subsidiary provided that 95 percent of all taxes that would have been paid by the subsidiary, if its return were filed independently and not consolidated with the railroad, would be paid by the subsidiary to the parent. Such payments would amount therefore to payment for the privilege of utilizing the accumulated tax loss carry-forwards of the railroad. Actually only two such agreements, with GSC and Strick, were ever signed. The agreement with Strick, negotiated by the NYC, also contained certain unique provisions where the subsidiary would receive payment for certain tax deductions used by the parent company (which was still profitable at the time) resulting in a credit to the subsidiary of $915.599, which was eventually offset against receivables owed to the parent company, upon merger of Strick Holding Co. into the PCTC in 1969. The agreement with GSC did result in the receipt of $2.15 million in common stock of that company in 1969 in partial payment of amounts owing under the allocation agreement (leaving a balance receivable at the end of 1969

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[63] Excluding the effects of this sale from the consideration of the total cash drain (for which there is some basis in view of the nature of the assets disposed of) would of course increase the net cash drain incurred by the railroad by a corresponding amount (to a total loss of $135.5 million for the PRR).

[64] $111.26 million excluding sale proceeds of L.I.R.R. Co.

[65] $112.4 million excluding sale proceeds of L.I.R.R. Co.

[66] As the table above reflects, on an average total annual cash return basis, the railroad realized an approximate 6 percent return on investment. (Such return does not, however, take into consideration dividends and interest payments on equity/debt securities used in making the acquisitions, which would reduce the net return figure by approximately 43 percent to 3.3 percent.)

[67] In addition, $4 million in preferred stock of GSC was also purchased by the railroad in 1965–1966 in order to assist the subsidiary in its financing needs.

of $5.82 million). However, no cash payment for such obligation was ever realized by the railroad.[68]

As the previous figures reflect, although the diversification program of the railroad was not the overall cash drain that some have portrayed it, it nonetheless did nothing to improve the railroad's cash flow problem either. Of some mystery, in this connection is why the railroad saw fit to resort in every acquisition to the heavy, if not sole use of cash as part of the purchase price—further depleting existing cash levels.[69] In only one acquisition, that of Buckeye Pipe Line, were equity securities (Pennsylvania Co. 4⅝ cum. preferred stock) employed as consideration,[70] and even there the initial $30.213 million investment was in cash. Cash would have been unquestionably the only weapon to have been used if the railroad had been seeking to secretly establish an ownership base from which to launch either a tender offer (after obtaining the maximum permissible limit without public disclosure of its holdings and investment purpose) or to have simply negotiated from strength. But these tactics were not employed by the railroad(s)—with the sole exception of the Buckeye transaction where the PRR did acquire an approximate ten percent interest in the company before disclosing such to the management of Buckeye.[71]

It is believed that, at that time, the railroad's (principally the PRR) securities were still possessed of sufficient value and attraction to have been used to a much greater extent than they were. In this regard the assertion that dividends payable on any such securities so issued would have worked an ever greater depletion of cash over the long period carries no weight. Excluding again the real estate development business sector, whose idiosyncrasies have been set forth above, there are other "growth" areas in which specific companies also pay reasonable dividends on their own stock, the proceeds from which could have offset considerably any dividends paid by the acquiring company on stock used in making the acquisition. Moreover, not until the proposed acquisition of Kayser-Roth in June, 1968, after merger, does this objective appear to have been of major consideration.[72]

Credit reserves

The diversification program and its related cost also had the added disadvantage, because of the low cash reserves problem, of forcing the parent company to borrow to replace the net cash loss effected (whether the latter was with respect to the railroad itself or its wholly-owned Pennsylvania Company subsidiary). It would be nearly impossible to trace what borrowings replaced what working capital source expenditures. However, using the information on total diversification-related cash funds expended on a yearly basis and total extraordinary additions to working capital, and considering the latter funds as replacements for the former, total interest costs [73] on the average working capital funds outstanding would have approximated between $16 and $18 million from 1963 through 1969. The calculation of such a figure admittedly

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[68] Furthermore, at the end of calendar 1970, railroad books reflected a balance owing GSC of $2.15 million under such agreements (apparently resulting from an interpretation of the agreement in regard to additional tax loss carry-forwards generated by GSC's 1970 losses). This obligation is, however, disputed by the railroad.

[69] See, for example, the Board memorandum utilized by S. T. Saunders in his report to the railroad's Board of Directors at the August 1964 meeting wherein it is stated: "Net cash at the end of July totaled $5,000,000 which compares with $13,200,000 at the end of August 1963." In the same Board memorandum, Saunders also reported: "Pennsylvania Co. on July 15th purchased 518,367 shares of stock of Great Southwest Corporation bringing the system holdings to 532.867 shares, or 54.94% of the total outstanding stock at an aggregate cost of $12,196,000." Appendix D, Exhibit 38, p. 561.

[70] Excluding the February 1970 acquisition of Southwest Oil Refining Co. (and Royal Petroleum Corp.) by Penn Central Co., accomplished solely by the use of preferred stock of the latter company, but later rescinded by court settlement entered 4/9/71 C.A. No. 70–C–135, U.S. Federal Dist. Ct. (S.D. Tex., Corpus Christi, Div.).

[71] But even then the railroad continued to make a substantial cash investment (approximately $20 million more) after such disclosure, before acquiring the remaining approximate two-thirds interest with Pa. Co. preferred stock.

[72] See memorandum utilized by S. T. Saunders in his report *re* proposed Kayser-Roth acquisition to the PCTC Board of Directors at the June, 1968 meeting wherein it is stated: ". . . there are obvious advantages in using securities, rather than cash, in a transaction of this size". Appendix D, Exhibit 7. Furthermore, although the Kayser-Roth negotiations were later terminated, the other non-rail acquisition made by the company, that of Southwest Oil Refining Corp. (acquired through the Penn Central Co.) was accomplished through the issuance of preferred stock. (A 23 percent interest investment in Madison Square Garden Corp. by PCTC was also accomplished primarily as the result of an exchange of stock held by the railroad in a subsidiary, for stock in Madison Square Garden Corp.)

[73] Interest computed at the average rate in effect for equipment financing for the railroad(s) for each of the years in question.

involves many hypotheticals and is no more than speculation. It is sufficient for our purposes to simply point out that substantial interest costs were involved in the replacement of working capital funds used for diversification purposes and at rates in excess of those that would have been paid if equity securities had been used as consideration instead of cash.

Also of significance to the railroad's total credit reserves, in addition to the borrowing it did to replace cash used for diversification-related costs, were the credit arrangements it made for its non-rail subsidaries (again almost exclusively for its real estate development operations and for Executive Jet Aviation, Inc.). Such bank loan arrangements were made nearly totally in reliance on the credit standing of the railroad (or more accurately, through its principal credit generating subsidiary, the Pennsylvania Company).[74] Once again it is nearly impossible to calculate the effect such non-rail subsidiary borrowing had upon the credit resources of the railroad, since those resources were principally derived from Pennsylvania Co., whose credit standing was in turn dependent in large measure upon the value of these same non-rail subsidiaries—the stocks of which were the principal assets of Pennsylvania Co. (along with the company's N&W holdings). The amounts borrowed by the real estate development companies and by EJA were of significant size, however, and did work at least a partial erosion upon the credit sources of the railroad (Pennsylvania Co.). Such effect is in further demonstration of the ill-advisedness of the investment selection by the railroad into areas with a patent need for large amounts of financing (to say nothing of the illegality of the proposed EJA objective).

Effect on management

No basis in fact was found for the assertion that the railroad's management diverted excessive or unwarranted attention and efforts to the diversification program, and to the affairs of non-rail subsidiaries after acquisition. There was some time expended at the PRR in reaching a decision as to how to reinvest the expected N&W proceeds, as well as in the earlier efforts of the "Committee on Pipelines of the PRR." Both these efforts, headed principally by the chief financial officer of the railroad, amount to little more than consideration of problems he would be expected to confront as manager of the financial resources of the company. The same can be said for time spent by D. C. Bevan and other members of the finance department staff (including W. R. Gerstnecker and J. E. Dermond, the principal financial analyst and, later, Assistant Vice President Corporate) in evaluating potential acquisition candidates.

Little time, relative to that expended on other corporate affairs, was devoted to diversification by S. T. Saunders, who, although approving such action, viewed such activities as primarily within the province of D. C. Bevan and the finance department. Some time was also, of course, devoted by the company's legal department in respect to legal problems attendant to the specific acquisitions (principally the monitoring of the mechanics of the acquisition itself), but other departments and/or officers of the company were clearly not involved in the acquisition program.

In addition, S. T. Saunders and D. C. Bevan also served as the railroad's principal representatives on the boards of directors of the acquired companies. After acquisition, other than the participation on the subsidiaries' boards, what little control existed over the affairs of the non-rail subsidiaries was solely in the

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[74] Demonstrative of this point is the fact that by the end of 1966 the capital structure of GSC, the railroad's principal real estate development subsidiary, had become so debt-ridden that a major Dallas bank (with whom it was even a depositor) would no longer loan funds to the corporation. (See letter dated 12/1/66 from D. C. Bevan to J. W. Aston, Chairman of the Board, Republic National Bank of Dallas, Appendix D, Exhibit 39, p. 564. Moreover, additional correspondence dated 9/22/67 from W. R. Gerstnecker, Treasurer of the PRR ; to C. J. Hodge reveals that within six months of the above Bevan letter the railroad had not only arranged two three-year loans totaling $6 million and another short-term loan of $3 million for GSC, but had purchased $3 million of that company's preferred stock through the railroad's system companies and was contemplating purchasing $2 million more, Appendix D, Exhibit 40, p. 564. Furthermore, top management officials of the First National City Bank of New York candidly admitted to the Committee's special staff that substantial loans were granted to EJA not on its own credit standing, but as the result of arrangements made by D. C. Bevan or W. R. Gerstnecker of the railroad. These officials further state that the bank always considered that it was dealing with the railroad on such occasions and it was on its credit standing (or more accurately, that of the American Contract Co. subsidiary and, later, the Pennsylvania Co., whose assets served as collateral when such loans were not secured by first equipment liens—where aircraft purchases were involved) that such loans were made.

form of (1) the submission of periodic financial reports (or more specifically, annual budgets and future planning and projections) to the railroad's finance department; (2) monthly meetings with the companies by D. C. Bevan and certain members of the finance department staff to review operating results and future planning, and (3) the review of annual audited statements of financial results. As these limited control measures might suggest, the subsidiaries, in practice, ran their affairs virtually autonomously.

The NYC management, on the other hand, expended little time or effort on diversification activities, making, of course, only the one acquisition of Strick in 1966 and also by giving great latitude to management of that subsidiary to control its own affairs.

The merged company continued the same practices with respect to non-rail subsidiary control as were employed by the PRR, with supervision of their activities given exclusively to D. C. Bevan and the financial department staff. Acquisition efforts were also continued by the same department in a manner similar to that of the PRR. Again, if anything, the same comment made in regard to too little control having been exercised by the PRR over its non-carrier subsidiaries can be made with equal application to the Penn Central.[75] Work in connection with the formation of the holding company primarily involved two members of the company's legal department and D. C. Bevan. Although certain officials (including S. T. Saunders and D. C. Bevan) did serve in dual capacities as officers and directors of both the railroad and the holding company, after formation of the latter in October, 1969, few activities were ever undertaken by it before the bankruptcy of the railroad nine months later and, correspondingly, few demands in connection with holding company matters were made upon the time of these officers.

In order to ascertain the role of the ICC in connection with the railroad's acquisition program, it is first necessary to understand the Commission's powers and responsibilities in regard to the regulation of the business and financial activities of the carriers within its jurisdiction, as well as its actions and policy determinations in regard to diversification by such carriers. A brief presentation of this background information follows.

Role of the ICC

The role of the Interstate Commerce Commission in connection with railroad diversification revolves around its function as the principal regulator of financial and business activities of the nation's surface transportation companies. Its specific powers, derived from the Interstate Commerce Act, are designed to keep it sufficiently informed of financial transaction details to fulfill its responsibilities, and are of two basic types: (1) provisions whereby the Commission can require the submission of certain operational (business and finance) information concerning the affairs of carriers within its jurisdiction, and (2) provisions whereby carriers within its jurisdiction are prevented from issuing securities in any form (whether equity or debt) without prior Commission approval.

POWERS

More specifically, under the Act the Commission has broad powers to secure information of nearly every type respecting the business activities and financial condition of the carriers within its jurisdiction. Of particular importance in this regard is Section 20 which confers in paragraphs 1 through 10, among other things, specific authority to require annual, periodical and special reports of carriers, as well as to prescribe how they shall be made. The Commission is also granted authority to prescribe a uniform system of accounts,

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[75] The autonomous manner in which the acquired companies ran their affairs is demonstrated in part by the number of major acquisitions which they made themselves and manner in which completed. For example, Richardson Mobile Homes, Inc., the nation's second largest manufacturer of mobile homes was purchased for in excess of $15 million by GSC in 1969 with only a passing reference being made to the completion of the transaction at the Penn Central Board meeting (and with little, if any, apparent guidance having been given, or offered GSC by the railroad's finance department). For a more detailed discussion of the lack of control by the Penn Central over its non-rail subsidiaries, see pp. 161–167 of "The Penn Central Failure and the Role of Financial Institutions," Staff Report of the Committee on Banking and Currency, U.S. House of Representatives, 92nd Cong., 1st Sess.

and to prescribe classes of properties for which depreciation charges can be included under operating expenses, including the rate of depreciation to be charged with respect to such property. In addition the section provides that all such accounts, books and records shall be open for inspection by the Commission, its accountants or duly authorized representatives.

In addition, Section 20a is of importance in regard to regulation of securities of such carriers. More particularly, carriers within the jurisdiction of the Commission are prohibited from issuing capital stock, bonds, or other evidence of indebtedness, or to assume any obligations or liability with respect to the securities of any other person without Commission authorization.

Authorization of the issuance of any such securities or the assumption of liability may be granted by the Commission only upon investigation and a finding that: (a) the transaction is for some lawful corporate purpose; (b) the transaction is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier; and (c) it will not impair its ability to perform that service.

Quite obviously, the above powers are rather sweeping in scope, but are, as indicated, applicable only to carriers within the Commission's jurisdiction. In this connection a brief examination of the limitations on the Commission's powers to apprise itself of the financial condition of a "carrier," or its parent, or to impose financial controls through exercise of its securities provisions, is in order.

LIMITATIONS ON POWERS

Powers accorded the Commission over mergers or consolidations of carriers within its jurisdiction are broad. Any business consolidation of such carriers is clearly unlawful unless specifically authorized by the Commission. Along similar lines, a non-carrier (whether, e.g., a parent holding company or otherwise) may not acquire controlling interest of a carrier, if it already controls one or more other carriers, without Commission approval.

Moreover, in the case where a holding company (or other non-carrier) controls two or more carriers, under the provisions of Section 5 (3) of the Act, it shall be considered a carrier, subjecting it to the reporting requirements (Section 20 (1) to (10)) and securities regulation provisions (Section 20a (2) through (11)) described above, to the extent prescribed by the Commission. Thus, a non-carrier possessing multiple carrier controlling interests becomes a carrier itself to the extent the Commission deems necessary in regard to monitoring its business operations and financial activities.

On the other hand Commission approval is not necessary where a non-carrier acquires control of one carrier. Furthermore, the Commission has also eschewed jurisdiction over any such non-carrier controlling but a single carrier and has therefore refused to subject it to the accounting and reporting provisions of Section 20 (with two limited exceptions) or the securities issuance requirements of Section 20a.

OTHER APPLICABLE INVESTIGATORY POWERS

Despite the above-mentioned limitations there are broad investigatory powers conferred upon the Commission by two other sections of the Act which could be employed in a case involving a non-carrier which controls a single carrier. For example, Section 12(1) confers upon the Commission authority to inquire into the business relationship between the non-carrier, or, more specifically ". . . in order to . . . carry out the objects for which it was created . . . , to inquire into and report on the management of the business of persons controlling, controlled by, or under common control with, such carriers, to the extent that the business of such persons is related to the management of the business of one or more such carriers . . ."

Moreover, Section 20(5) authorizes the Commission ". . . to inspect and copy any and all accounts, books, records, memoranda, correspondence, and other documents . . . of any person controlling, controlled by, or under common control with any such carrier, as the Commission deems relevant to such person's relations to or transactions with such carrier."

POLICY OF ICC TOWARD DIVERSIFICATION AND APPLICATION OF EXISTING POWERS

The position taken by the Commission in regard to diversification by, or involving, carriers within its jurisdiction is perhaps best set forth in a brief case history of the issue.

For nearly 50 years the clear policy of the ICC was that the major endeavors of a carrier should be confined to matters relating to transportation. Although there has been considerable refinement to this position, clearly this attitude has been primarily responsible for the creation of parent holding companies by carriers as the corporate instruments for implementing their diversification programs.

The initial attitude sprang from a 1913 investigation of the financial collapse of the New Haven Railroad—the conclusions from which asserted, among other things, that the problems of the company stemmed from the misfortunes and derelictions connected with its extensive extra-carrier activities. Finding that the railroad would not have been in financial difficulties had it not been for these outside undertakings, the Commission in that case stated:

> Every interstate railroad should be prohibited from expending money or incurring liability or acquiring property not in the operation of its railroad or in the legitimate improvement, extension or development of that railroad.[76]

Acting upon these findings, Congress later adopted into law (in 1920) the securities monitoring provisions of Section 20a which have been set forth above. Such legislation clearly granted the Commission the right to prevent the issuance of securities or the assumption of financial obligations by a carrier unless it is found by the Commission that it is "necessary or appropriate for or consistent with a proper performance by the carrier of service to the public as a common carrier and . . . will not impair its ability to perform that service."

Since that time, however, significant modifications of that initial rigid position have taken place. The first modification took place somewhat ironically in connection with another New Haven investigation years later.[77] While extending the above-mentioned restriction in this case to all railroad subsidiaries and reaffirming its initial position to the extent of stating that a railroad's resources should "ordinarily be devoted to the proper development of its own transportation system," the Commission nonetheless held that under certain conditions non-carrier investment could be undertaken. These conditions briefly were that the Commission, in approving such investment, must find that it "constitutes a proper use of railroad funds or credit; that the terms of the transaction are reasonable; and that the investment is in the public interest." Specifically exempted from these restrictions were those "investments such as are permissible for savings banks and trustees." [78]

The two major cases having the most significant impact on the diversification issue were, however, to be decided in the early 1960's. The first of these involved the Bangor and Aroostock Railroad, a small Maine road, which formed the first of the modern-day parent holding companies, the Bangor and Aroostock Co.—which was then merged with the Punta Alegre Sugar Co. to form the Bangor Punta Co. In order to understand the significance of the next series of events it should be recalled that under Sec. 5(2) acquisition of a carrier is not subject to Commission approval unless the acquiring party is itself a "carrier" under applicable federal statutes (subjecting it to Commission jurisdiction—more specifically the provisions of Section 20a) or unless the non-carrier acquiring party's proposed acquisition involves control of two or more carriers (including in that number any already controlled by the acquiring party).

At the time of the formation of the Bangor and Aroostock Co., in 1960, the B&A Railroad did control another carrier (the Van Buren Bridge Co.). However, the Commission, establishing a precedent which it was to follow in the numerous holding company cases which have since arisen, held that the two carriers were "constituents of a single integrated system" and shunned jurisdiction over the holding company (and its successor, Bangor Punta Co.). The princi-

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[76] No. 4845 New England Investigation, 27 I.C.C. 560.
[77] Investigation of New York, New Haven and Hartford Railroad Co., 220 I.C.C. 505 (decided April 5, 1937).
[78] Id. at p. 616.

pal effect of such decision was, of course, to make its prior non-diversification policy toward its regulated carriers inapplicable to such holding companies, a position which persists to the present time.

A second important decision two years later involved what might well be construed as a reversal, or at least a major modification of the earlier Commission policy regarding diversification by a carrier itself. The specific case concerned an application by the Greyhound Corp. (while that company was still solely a carrier)—to issue a sufficient amount of its own stock to acquire controlling interest of Boothe Leasing Corp., an industrial equipment leasing company. In a narrow decision (with five of the Commission's members dissenting), the ICC granted its approval of the transaction. The order of approval is of importance in this connection because of the majority opinions contained therein.[79] Recognition of diversification as a legitimate self-help measure to offset unsatisfactory carrier revenues is inherent in the opinion. More specifically:

> The proposed acquisition by Greyhound of Boothe is part of a diversification program designed to stabilize and increase its earnings, and thereby improve its ability to provide the public with common carrier passenger service by bus . . .

The Commission also noted that in other past instances it had granted approval of non-carrier investment by carriers, but "in those instances in which management proposals for diversification appeared improvident, such proposals have been disapproved as not in the public interest."[80] Moreover, the majority cautioned that "In no event should a carrier be authorized to issue securities or use the proceeds therefrom, or assume obligations or liability with respect to the securities of any other person where it is not for some lawful object within its corporate powers; is not compatible with the public interest, and where it would impair in any respect the carrier's ability, financial or otherwise, to perform its service to the public as a common carrier . . ."[81]

More importantly, the Commission observed:

> Judicious common-carrier investment in stable non-carrier business enterprises, if limited, would contribute to the provisions of a soundly financed common-carrier system, and would not do violence to the principle that corporations endowed with a public interest should direct their primary activities to the public-service nature of their operations.[82]

The vigorous opinion of the five dissenting Commissioners, asserting that the ICC was mistakingly applying standards to a carrier that should be applied solely to a non-carrier holding company that was within the jurisdiction of the Commission, added this observation:

> If this precedent is to be followed, adequate supporting evidence at least should be required to inform the Commission as to the non-carrier business concerned, its financial condition and accounting methods, so that it [the ICC] might make an educated appraisal of the "judiciousness" of the investment as support for the new standard.[83]

However, despite this opportunity for diversifying within the confines of its own corporate structure, albeit in a somewhat circumscribed manner, carriers for a variety of reasons (principal among them the desire to pursue diversification programs in a completely untrammeled manner) have resorted to the formation of parent holding companies over the past few years.[84] Adhering to its B&A precedent, the Commission has generally followed a policy of dismissing all carrier applications for authority to make these corporate changes (i.e. the assumption of control by the holding company over the carrier) on the basis that the Commission lacks the jurisdiction to even consider them. In the two cases which were found to come within the jurisdiction of the ICC, involving Northwest Industries and Illinois Central Industries, the Commission has chosen to invoke but limited supervisory powers and has required the submittal of only a minimal amount of reports.

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[79] Interstate Commerce Commission, Finance Docket No. 21801, Greyhound Corp. Stock, 90 M.C.C. 215, 218 (decided March 19, 1962).
[80] Id., at p. 220.
[81] Id., at p. 222.
[82] Id., at p. 223.
[83] Id., at p. 228.
[84] Included among this group are the Missouri, Kansas and Texas, the Chicago and Northwestern, the Seaboard Coast Line, the Union Pacific, the Boston and Maine, the Illinois Central, the Atcheson, Topeka and Santa Fe, the Kansas City Southern and the Penn Central itself.

The more recent developments regarding holding companies have both involved Northwest Industries, the parent company of the C&NW. The first of these, in connection with the then pending C&NW-Milwaukee merger case, was reflected in the hearing examiner's report which strongly recommended (in approving the merger) that Northwest Industries should at least be required to file with the Commission a more complete set of reports under Sections 20 (1) through (10) in regard to its business and financial activities.

A similar recommendation was urged by the ICC Bureau of Enforcement in a brief filed in connection with a group of cases involving control of the Chicago, Rock Island and Pacific Railroad.[85] In the event of approval of the C&NW application, the Bureau also urged that the Commission subject the C&NW's parent, Northwest Industries, to more extensive reporting requirements.

Of importance, however, is the fact that in none of the above cases involving Northwest Industries, or in the Illinois Central jurisdiction extension, was there any reference to the securities issuance veto powers granted to the Commission under the Act.[86] Furthermore, in no known case have the securities provisions been enforced with respect to a parent holding company.[87]

FORMATION OF HOLDING COMPANY (PENN CENTRAL COMPANY) BY PCTC

In 1969 the PCTC created its own parent holding company, the Penn Central Company—activating its operations on October 1 of that year.[88] Reasons for its formation were essentially the same as those advanced in connection with the above discussion but principally involved the desire on the part of the railroad to create a corporation possessing greater flexibility to carry out a large scale program of diversification (by avoiding the securities provisions of Section 20a).[89]

Under the new corporate structure, the holding company became the owner of all outstanding stock of the railroad, with the holdings of the latter's shareholders becoming the stock of the parent holding company on a share for share basis.[90]

Initial plans for the holding company called for the eventual minimum transfer of (1) the real estate companies; (2) Buckeye Pipe Line Co.; (3) all N&W stockholdings; and (4) the Park Avenue properties subject to mortgage, to its direct ownership.[91] None of these actions were, however, accomplished—primarily because of the intervening railroad bankruptcy.

Certain procedural matters in connection with the creation of the holding company were also of significance. More specifically, the Penn Central holding company, in its application (to the ICC) under Section 5(2) of the Interstate

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[85] Interstate Commerce Commission, Finance Docket No. 22688, C&NW-control-Rock Island, Bureau of Enforcement. Brief filed January 27, 1969.

[86] The extension of these provisions to a parent non-carrier holding company (again Northwest Industries) was argued in a petition by a private party, B.F. Goodrich & Co., in connection with a takeover attempt by Northwest (filed in Finance Docket No. 23388, Chicago and Northwestern Railway Co.—Merger—Chicago and Great Western Railway Co.—wherein the Commission had reserved jurisdiction in regard to imposing statutory requirements on Northwest Industries other than certain reporting provisions of Section 20.) However, the Commission eschewed any power to so act.

[87] Holding companies argue basically that extension of the securities provisions to them would have a detrimental effect on their diversification efforts because of the attendant delay which would allegedly prevent them from successfully competing for the acquisition of non-rail companies. In addition it is contended that such veto power would involve the Commission in a decision, that of investment selection, which is properly that of management For an excellent discussion of the entire rail diversification issue, including a detailed description of the evolvement of ICC policy in this area see "Conglomerates and Public Responsibility " by Colin Barrett, *Traffic World,* March 1, 1969, pp. 86–91. Appendix D, Exhibit 41, p. 565.

[88] Formation of the holding company had been considered as early as June, 1968 but had been deferred principally because of the interference such action would have presented with the then proposed acquisition of Kayser-Roth by Pennsylvania Company. See memoranda dated 6/25/68 "Re:. Creation of a non-carrier parent for Penn Central." Appendix D, Exhibit 42, p. 572.

[89] A more detailed discussion of these reasons is contained in an internal memorandum dated 6/5/68 from E. K. Taylor, of the PCTC legal department to D. C. Bevan, Appendix D, Exhibit 43, p. 572.

[90] Moreover, the holding company corporate organization (due primarily to obligations owing to public stockholders) was, of course, independent from that of the railroad, although several members of top management of both companies, e.g., the Chairman of the Board and the President also occupied similar positions with the holding company simultaneously. Moreover, the Board of Directors of the holding company became the principal board in the system—concerning itself basically with business and policy matters effecting the entire company, but whose membership was nearly identical to that of the railroad.

[91] See memorandum dated 1/20/69 from Basil Cole to S. T. Saunders Appendix D, Exhibit 44, p. 574. Essentially then, had the planned asset transfers taken place, the creation of the holding company would have amounted to a reincorporation and restructuring of Pennsylvania Co. (plus the inclusion of the Park Avenue properties) in a parent company position.

Commerce Act for approval to control the railroad and carriers controlled by it, requested that the Commission take jurisdiction over the holding company as a person controlling two or more carriers. (The approach of course contrasted to the approach other holding companies had taken of filing with such application an accompanying motion for dismissal for lack of jurisdiction.) However, in this connection, the Penn Central holding company further requested that it be subjected to ICC jurisdiction over its accounts and reports (Section 20 (1) to (10), inclusive), but that it not be subjected to Commission jurisdiction over issuance of its securities (Sections 20a (2) through (11). This seeming voluntary gesture to keep the Commission informed of its activities was not so much the latter as it was the desire on the part of the holding company to avoid an adverse multi-million dollar impact on net income every year ($8 million using 1968 figures) resulting from the SEC deferred tax accounting treatment [92] which would be applicable if the holding company were not subject to ICC accounting jurisdiction.

On the other hand, subjection of the holding company to the securities provisions of Section 20a would have ostensibly defeated the purpose for forming the holding company. As was expected, however, on June 7, 1969, the Commission denied it possessed jurisdiction over the parent company and dismissed the application.

In its short period of existence only one acquisition, that of Southwest Oil Refining Co. (and its subsidiary Royal Petroleum Corp.) was attempted by the holding company. (This acquisition, consummated in February 1970 through the issuance of preferred stock, was later rescinded as the result of legal action instituted by former shareholders of the acquired companies.) [93]

ROLE OF ICC IN PCTC (AND PREDECESSOR COMPANIES) DIVERSIFICATION PROGRAM(S)

It is of significance to note that in only one acquisition, that of Buckeye Pipe Line Co., was ICC action required. This was in connection with the approval proceedings concerning the issuance of Pennsylvania Co. preferred stock to acquire the remaining approximate two-thirds of the Buckeye outstanding stock. No difficulty was encountered by the PRR in connection with obtaining approval here, with the record (see summary opinion by Division 3 of the Commission) [94] reflecting that not even a formal hearing was held in connection with the issuance approval.

However, each of the remaining acquisitions was accomplished by the carrier with cash, one of the primary reasons for whose use was clearly to circumvent the provisions of Section 20a—which is triggered only when securities are proposed for issuance—despite the fact that the transactions were of the very nature which the statute was specifically designed to monitor (non-carrier investment). Thus by merely changing the form of consideration from securities to cash (of which the company was in great shortage) the railroad was able to defeat the supervisory responsibilities of the Commission and effectively achieve holding company status itself.

CONCLUSIONS AND RECOMMENDATIONS

The pitfalls of diversification had been earlier discussed in trade journals:

"Delving somewhat into the realm of the hypothetical—since the short history of rail operations leaves a paucity of actual examples—the opponents suggest that future problems might arise if one of the conglomerates acquired a highly 'capital-intensive' company (i.e. one requiring a high level of capital investment for optimum performance). Such a firm, they say, would stand as a great incentive for the conglomerate to divert into its operations rather than to the less profitable railroad activities, available capital funds." [95]

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[92] Companies subject to these provisions must include in their income accounts for stockholder purposes, a charge for deferred federal income taxes.

[93] Although the effect of the railroad's bankruptcy on its parent's financial strength is self-evident, (the stock of the railroad being nearly its sole asset), nonetheless the holding company itself is not in bankruptcy.

[94] Interstate Commerce Commission, Finance Docket No. 23019, Pennsylvania Co. Stock, 324 ICC 275 (decided July 13, 1964).

[95] 'Conglomerates and Public Responsibility," by Colin Barrett, *Traffic World,* March 1, 1969, pp. 86–91; reproduced in Appendix D, Exhibit 41, p. 565.

Acquisitions of real estate development operations by the Penn Central were exactly the type of capital-intensive companies mentioned here, and whose activities were hardly those of the "stable non-carrier enterprises" referred to by the Commission in the Greyhound case. Moreover, in another article by Alan Roth in *The Institutional Investor* in regard to the financial aspects of diversification by carriers, Mr. Roth pointed to some of the problems that could well arise, offering the observation that diversification "will be more difficult than the first blush of initial expectations would indicate." "Rail management," he further observed, "is on the whole inexperienced in the highly competitive and sophisticated acquisition business. Companies which have led the way in diversification have principally been managed by lawyers or investment bankers, as opposed to traditional railmen." [96] To this comment it might be added that even when such companies are managed or advised by "lawyers or investment bankers" there is no guarantee that noncarrier investments made will be sound ones taking into account the carriers objectives and needs—as witnessed in the PCTC case at hand.

. Referring to the above-mentioned Barrett article again, it is stated therein by the author that "Virtually no one—and certainly no responsible person—is seeking to block all railroad expansion beyond the transportation industry. There are, however, many who are fearful that untrammeled expansion could bring railroads more trouble than benefits." [97]

The Penn Central experience by itself does not suggest that an absolute prohibition of diversification is required; but it does support observations such as those made by Mr. Roth and Mr. Barrett. Considering real needs of the carrier in providing transport service, the Penn Central diversification program as conceived and implemented caused a loss of substantial cash to the railroad at the very time it could ill afford such loss. The loss was not offset by sufficient gain to justify the program. The Penn Central diversification program is a paradigm of what can happen (and has in other carrier situations) when carriers, despite their demonstrated public interest nature, are permitted to invest their corporate resources in noncarrier business in a totally unrestrained manner.

ASSESSMENT OF RELATIVE AND ABSOLUTE WEIGHT OF DIVERSIFICATION AS A FORCE LEADING TO BANKRUPTCY

The diversification program of the railroad(s) was not a major cause of the bankruptcy. A summary of the findings leading to this conclusion are as follows:

1. By virtue of the earnings maximization policy of management the nonrail acquisitions gave the appearance of achieving a quite satisfactory return on investment in terms of reportable earnings from the inception of the program in 1964 through 1969, contributing substantial percentages of *reported* consolidated earnings in that period while rail operations continued at a deficit. Without the benefit of these added reportable earnings it is probable that the rail plight would not have been obscured so successfully and, financial pressures would have been brought to bear much sooner resulting in an earlier bankruptcy. It was not until calendar year 1970, *post-bankruptcy*, that the principal real estate development acquisitions recorded their large losses. Investors and the public generally might find a delay in the bankruptcy of questionable value.

2. While the program as implemented, unquestionably precipitated a cash drain over the six year period (reflecting the inappropriateness of the types of investments made) such amounts were not significant by themselves when compared to the total funds which the railroad continued to reinvest in its rail plant over a good portion of the same period.

3. Although substantial amounts of time were devoted to the diversification efforts by certain members of the railroad's finance department and, to a much less extent, the Chairman of the Board, few other officials (none in the

[96] "The Railroads: What Will Diversification Mean to Earnings?" by Alan Roth, *The Institutional Investor*, October 1968, pp. 74–75.

[97] "Conglomerates and Public Responsibility," *op. cit.*, at p. 89.

rail operating departments) were involved to any extent. It is probable that such efforts did not measurably detract from management's capability to operate the railroad.

4. The bank loans arranged by the parent company for its non-rail subsidiaries had little effect on lines of credit which the railroad could have used to forestall bankruptcy. This was because the railroad was for all practical purposes wholly reliant upon its Pennsylvania Company subsidiary as its principal credit generating corporate instrument—whose assets were in large part the stock of the non-rail subsidiary companies. The arranging of loans to improve the operating performance of its subsidiaries was an attempt to increase the value of its only pledgable assets since nearly all of the railroad's own assets already served as collateral for its prior loans.

In relative terms the total impact of diversification was by itself a small factor in the bankruptcy of the railroad. At worst, the adverse effect on the cash position of the railroad it produced was no more significant than the inadequate pre-merger planning by both railroads leading to the disruptive service problems faced by the company immediately after merger. The effects of the latter on existing and prospective shippers left a far greater impression in terms of total revenues lost than did the total cash expended during the seven year period on the diversification program.

For that matter revenues lost from various industry strikes involving shippers, severe weather conditions during the short period of the merged company's existence, costs associated with the labor protective agreement (the latter of which were, however, minimal by the company's own admission) and the New Haven inclusion also contributed to the financial burdens of the merged company.

For the reasons advanced above it is believed that the most appropriate solution to the adverse effects of the PCTC acquisition program may not be total prohibition of all outside investment, but rather the imposition of control by the Interstate Commerce Commission over the types of non-carrier investment that a carrier or its parent holding company may be permitted.

RECOMMENDATIONS

The diversification program of the Penn Central is clearly a model for the prevention of untrammeled non-carrier investment by a carrier. Although it is acknowledged that some benefits may be achieved through a soundly conceived and implemented program of diversification, the Penn Central case (as well as several others examined by the ICC in studies over the past two years) strongly demonstrates the need for the imposition of standards and controls over such activity by carriers.

It is, however, recognized that the mere extension of Section 20a to apply to non-rail cash acquisitions by carriers or the additional strengthening of the approval proceedings thereunder (including the prescribing of more comprehensive types of information to be submitted) would be largely useless today because of the advent of the holding company device to avoid Interstate Commerce Commission jurisdiction. Simply forming a holding company should not also have the undesirable side effect of insulating the carrier from the Interstate Commerce Act. Because of the demonstrated opportunities for impairment to the financial condition and service ability of a carrier that ownership or control by a non-carrier presents (whether by creation of the carrier itself or not) and the evident public interest involved in maintaining the nation's existing rail resources, it is strongly recommended that the Commission use its existing power under the Act as outlined below or failing that, that it explain in detail how the Act is deficient and how it should be amended. The recommendations are as follows:

(1) that any person controlling a carrier be subject to the provisions of Sections 12, 20 (1) through (10), and Section 20a (2) through (11) of the Interstate Commerce Act;

(2) that the Commission require the submission of any and all information deemed relevant to a proper assessment of the business

and financial activities of any such controlling person in order to carry-out its responsibilities under the Interstate Commerce Act (including e.g. the assessment of the effect of such activities upon the carrier and its ability to perform its service to the public); [98]

(3) that the Commission require the submission of any and all information it deems relevant to making a determination as to the judiciousness of a non-carrier investment (including e.g. the nature of the non-carrier business concerned, its financial condition and accounting methods) where the purpose of the issuance of the securities involved is that of (or assumption of financial obligation is related to) non-rail investment; and

(4) that the Commission examine proposed acquisition by carriers (or controlling persons thereof) of any non-carrier business enterprise by the utilization of cash as the sole means of consideration.

The adoption of the above recommendations would not necessarily prohibit the continued use of diversification by carriers. But it would provide a controlled environment which would help prevent investment in business areas whose activities or financial demands are incompatible with the needs and objectives of the carrier.[99] It is noted that the ICC in late 1970 and in 1971 submitted legislative proposals related to diversification. The Senate Committee on Commerce deferred action on any legislation pending the completion of this report. The second proposal (S. 2760 in the 92nd Congress—HR. 11030 in the House) represented a significant retreat by the ICC from its initial proposal introduced late in the 91st Congress in the House as H.R. 19720 Much could be achieved by the Commission under existing law, but the Congress should consider the necessity for new legislation in the light of ICC reaction to the recommendations of this report.

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[98] The present form (Form BF–6) used to request information is so overly simplistic in regard to the type of information requested as to be of limited use. In addition, with the relatively small staff available for investigating even the information presently submitted, challenges by the government to the issuance rarely develop. Those that do are usually the result of opposition by some interested third party. (See Appendix, Exhibit 45 for a sample copy of Form BF–6 and general instructions).

[99] The standard for investment might well encompass those advanced by the Commission in the Greyhound case: "In no event should a carrier be authorized to issue securities or use the proceeds therefrom, or assume obligation or liability with respect to the securities of any other person where it is not for some lawful object within its corporate powers; is not compatible with the public interest, and where it would impair in any respect the carrier's ability to perform its service to the public as a common carrier." Finance Docket No. 21801. Greyhound Corp. Stock.

APPENDIX A

TABLE A-1.—INTERCITY FREIGHT BY MODES, 1939-70[1]

[Billions of ton-miles]

	Rail	Percent	Truck[1]	Percent	Oil pipe-line	Percent	Great Lakes	Percent	Rivers and canals	Percent	Air	Percent	Total
1939	339	62.3	53	9.7	56	10.3	76	14.0	20	3.7	0.01	0	544
1940	379	61.3	62	10.0	59	9.5	96	15.5	22	3.6	.02	0	618
1941	482	62.4	81	10.5	68	8.8	114	14.8	27	3.5	.02	0	772
1942	645	69.5	60	6.5	75	8.1	122	13.1	26	2.8	.04	0	928
1943	735	71.3	57	5.5	98	9.5	115	11.2	26	2.5	.05	0	1,031
1944	747	68.7	58	5.3	133	12.2	119	10.9	31	2.8	.07	.01	1,088
1945	691	67.2	67	6.5	127	12.4	113	11.0	30	2.9	.09	.01	1,028
1946	602	66.6	82	9.1	96	10.6	96	10.6	28	3.1	.08	.01	904
1947	665	65.3	102	10.0	105	10.3	112	11.0	35	3.4	.11	.01	1,019
1948	647	61.9	116	11.1	120	11.5	119	11.4	43	4.1	.15	.01	1,045
1949	535	58.3	127	13.8	115	12.5	98	10.7	42	4.6	.20	.02	917
1950	597	56.2	173	16.3	129	12.1	112	10.5	52	4.9	.30	.03	1,063
1951	655	55.6	188	16.0	152	12.9	120	10.2	62	5.3	.34	.03	1,177
1952	623	54.4	195	17.0	158	13.8	105	9.2	64	5.6	.34	.03	1,145
1953	614	51.0	217	18.0	170	14.1	127	10.6	75	6.2	.37	.03	1,203
1954	557	49.6	213	19.0	179	15.9	91	8.1	83	7.4	.38	.03	1,123
1955	631	49.5	223	17.5	203	15.9	119	9.3	98	7.7	.49	.04	1,274
1956	656	48.4	249	18.4	230	17.0	111	8.2	109	8.0	.58	.04	1,356
1957	626	46.9	254	19.0	223	16.7	117	8.8	115	8.6	.68	.05	1,336
1958	559	46.0	256	21.1	211	17.4	80	6.6	109	9.0	.70	.05	1,216
1959	582	45.3	279	21.7	227	17.7	80	6.2	117	9.1	.80	.06	1,286
1960	579	44.1	285	21.8	229	17.4	99	7.5	121	9.2	.89	.07	1,314
1961	570	43.5	296	22.7	233	17.8	87	6.6	123	9.4	1.01	.08	1,310
1962	600	43.8	309	22.5	238	17.3	90	6.6	133	9.7	1.30	.09	1,371
1963	629	43.3	336	23.1	253	17.4	95	6.5	139	9.6	1.30	.09	1,453
1964	666	43.2	356	23.1	269	17.4	106	6.9	144	9.3	1.50	.10	1,543
1965	709	43.3	359	21.9	306	18.7	110	6.7	152	9.3	1.91	.12	1,638
1966	751	43.0	381	21.8	333	19.1	116	6.6	164	9.4	2.25	.13	1,747
1967	731	41.4	389	22.0	361	20.5	107	6.1	174	9.9	2.59	.15	1,765
1968	757	41.2	396	21.5	391	21.3	112	6.1	179	9.7	2.90	.16	1,838
1969	780	41.0	404	21.3	411	21.6	115	6.0	188	9.9	3.20	.17	1,901
1970(p)	773	40.1	412	21.4	431	22.4	116	6.0	190	9.9	3.40	.18	1,925

(p)—Preliminary.
[1] Includes both for-hire and private carriers.

TABLE A-2.—COMPOSITION OF GROSS NATIONAL PRODUCT BY MAJOR SECTORS, 1929–70

[1958 dollars in billions; index: 1947=100]

Year	Gross national product		Durable goods		Nondurable goods		Services		Government purchases		Fixed investment	
	Dollars	Index	Dollars	Index	Dollars	Index	Dollars	Index	Dollars	Index	Dollars	Index
1970	724.1	234	82.0	332	207.9	192	187.2	255	141.8	355	99.8	193
1969	727.1	235	84.9	344	201.2	186	181.6	247	147.8	370	104.1	201
1968	707.2	228	81.4	330	196.5	181	174.4	238	148.3	372	98.8	191
1967	675.1	218	72.9	295	190.2	176	167.0	227	140.2	351	93.5	181
1966	658.1	212	71.7	290	187.0	173	159.4	217	126.5	317	95.4	184
1965	617.8	199	66.6	270	178.6	165	152.5	208	114.7	288	90.1	174
1964	581.1	187	59.0	239	170.3	157	144.4	197	111.2	279	81.9	158
1963	551.0	178	53.7	217	162.2	150	137.4	187	109.6	275	76.7	148
1962	529.8	171	49.2	199	158.2	146	131.1	178	107.5	269	73.4	142
1961	497.2	160	43.9	178	153.0	141	125.6	171	100.5	252	67.0	130
1960	487.7	157	44.9	182	149.6	138	121.6	166	94.9	238	68.9	133
1959	475.9	154	43.7	177	146.8	135	116.8	159	94.7	237	68.8	133
1958	447.3	145	37.9	153	140.2	129	112.0	153	94.2	236	62.4	121
1957	452.5	146	41.5	168	138.7	128	108.0	147	89.3	224	67.6	131
1956	446.1	144	41.0	166	136.2	128	104.1	142	85.3	214	69.5	134
1955	438.0	141	43.2	175	131.7	122	99.3	135	85.2	213	69.0	134
1954	407.0	132	35.4	143	125.5	116	94.8	129	88.9	223	61.4	119
1953	412.8	133	35.3	143	124.4	115	91.1	124	99.8	250	60.2	116
1952	395.1	128	30.8	125	120.8	111	87.8	120	92.1	231	57.2	111
1951	383.4	124	31.5	128	116.5	108	84.8	115	75.4	189	59.0	114
1950	355.3	115	34.7	141	114.0	105	81.8	111	52.8	132	61.0	118
1949	324.1	105	28.4	115	110.5	102	77.6	106	53.3	134	51.9	100
1948	323.7	105	26.3	107	108.7	100	75.8	103	46.3	116	55.9	108
1947	309.9	100	24.7	100	108.3	100	73.4	100	39.9	100	51.7	100
1946	312.6	101	20.5	83	110.8	102	72.1	98	48.4	121	42.3	82
1945	355.2	115	10.6	43	104.7	97	67.7	92	156.4	392	22.6	44
1944	361.3	117	9.4	38	97.3	90	64.7	88	181.7	455	15.9	31
1943	337.1	109	10.2	41	93.7	87	61.8	84	164.4	412	12.9	25
1942	297.8	96	11.7	47	91.3	84	58.5	80	117.1	294	17.3	34
1941	263.7	85	19.1	77	89.9	83	56.3	77	56.3	141	32.0	62
1940	227.2	73	16.7	68	84.6	78	54.4	74	36.4	91	28.1	54
1939	209.4	68	14.5	59	81.2	75	52.5	71	35.2	88	23.5	46
1938	192.9	62	12.2	49	77.1	71	50.9	69	33.9	85	19.4	38
1937	203.2	66	15.1	61	76.0	70	52.0	71	30.8	77	24.5	47
1936	193.0	62	14.5	59	73.4	68	50.5	69	31.8	80	20.9	40
1935	169.5	55	11.7	47	65.9	61	47.9	65	27.0	68	15.6	30
1934	154.3	50	9.4	38	62.5	58	46.1	63	26.6	67	12.1	23
1933	141.5	46	8.3	34	58.6	54	46.0	63	23.3	58	9.7	19
1932	144.2	47	8.4	34	60.4	56	45.9	62	24.2	61	10.9	21
1931	169.3	55	11.2	45	65.6	61	49.4	67	25.4	64	19.2	37
1930	183.5	59	12.9	52	65.9	61	51.5	70	24.3	61	28.0	54
1929	203.6	66	16.3	66	69.3	64	54.0	74	22.0	55	36.9	71

Source: Economic Report of the President, 1971.

TABLE A-3.—INCOME STATEMENT, CLASS I RAILROADS, 1960–70

[Dollar amounts in thousands; index, 1960=100]

	1960		1961		1962		1963		1964		1965	
	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index
Total operating revenue	$9,514,294	100.0	$9,189,138	96.6	$9,439,895	99.2	$9,559,522	100.5	$9,856,527	103.6	$10,207,850	107.3
Freight revenue	8,025,423	100.0	7,739,044	96.6	7,991,146	99.6	8,146,131	101.5	8,455,457	105.4	8,835,958	110.1
Passenger revenue	640,268	100.0	624,688	97.6	619,056	95.1	588,104	91.9	577,910	90.3	553,056	86.4
Mail revenue	331,378	100.0	341,697	103.1	343,588	103.[illegible]	338,684	102.2	329,169	99.4	311,341	94.0
Total operating expenses	7,565,336	100.0	7,274,260	96.2	7,418,562	98.1	7,451,648	98.5	7,737,847	102.3	7,849,841	103.8
Maintenance: Way and structure	1,191,690	100.0	1,117,680	93.8	1,154,802	96.9	1,182,507	99.3	1,225,759	102.8	1,235,801	103.7
Maintenance: Equipment	1,759,828	100.0	1,683,363	95.7	1,743,639	99.1	1,731,735	98.4	1,763,786	100.2	1,774,878	100.8
Transportation	3,832,882	100.0	3,710,832	96.8	3,755,092	98.0	3,771,254	98.4	3,920,622	102.3	4,020,161	104.9
Operating ratio (percent)	79.52	100.0	79.16	99.5	78.59	98.8	77.95	98.0	78.50	98.7	76.90	96.7
Net operating revenue	1,948,958	100.0	1,914,878	98.3	2,021,333	103.7	2,107,874	108.2	2,118,679	108.7	2,358,009	121.0
Railway tax accruals	998,799	100.0	991,083	99.2	905,044	90.6	886,387	88.7	870,581	87.2	916,494	91.8
Railway operating income	950,159	100.0	923,794	97.2	116,289	117.5	1,221,487	128.5	1,248,098	131.4	1,441,515	151.7
Equipment and facility rents	366,143	100.0	386,023	105.4	390,610	106.7	415,828	113.6	429,886	117.4	479,999	131.1
Net railway operating income	584,016	100.0	537,771	92.1	725,679	124.3	805,659	138.0	818,213	140.1	961,516	164.6
Other income	346,328	100.0	322,281	93.1	325,575	94.0	330,074	95.3	368,891	106.5	365,389	105.5
Total income	930,344	100.0	860,052	92.4	1,051,254	113.0	1,135,733	122.1	1,187,103	127.6	1,326,905	142.6
Total fixed charges	372,751	100.0	369,111	99.0	366,817	98.4	367,970	98.7	380,420	102.1	400,665	107.5
Income after fixed charges	494,799	100.0	428,976	86.7	612,705	123.8	694,065	140.3	739,106	149.4	855,607	172.9
Ordinary income [1]	444,640	100.0	382,444	86.0	571.017	128.4	651,637	146.6	698,184	157.0	814,629	183.2
Cash flow	1,191,693	100.0	1,073,155	90.1	1,023,229	85.9	1,226,326	102.9	1,383,824	116.1	1,521,210	127.6
Net income												
Net railway operating income before Federal income taxes	786,919	100.0	780,227	99.2	882,483	112.1	969,768	123.2	956,131	121.5	1,125,172	143.0
Ordinary income before Federal income taxes	647,543	100.0	624,900	96.5	727,803	112.4	815,746	126.0	836,103	129.1	978,285	151.1
Total cash dividends	385,493	100.0	357,561	92.8	368,164	95.5	378,549	98.2	457,188	118.6	470,800	122.1

[1] Prior to 1967 reported as net income.

Source: ICC, AAR, Moody's Transportation Manual.

TABLE A-3.—INCOME STATEMENT CLASS I RAILROADS, 1960-70—Continued

	1966		1967		1968		1969		1970	
	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index
Total operating revenue	$10, 654, 666	112. 0	$10, 366, 041	109. 0	$10, 854, 678	114. 1	$11, 450, 325	120. 3	$11, 991, 658	126. 0
Freight revenue	9, 280, 613	115. 6	9, 130, 233	113. 8	9, 749, 788	121. 5	10, 346, 258	128. 9	10, 921, 813	136. 1
Passenger revenue	543, 632	84. 9	485, 369	75. 8	444, 334	69. 4	438, 667	68. 5	420, 452	65. 7
Mail revenue	303, 999	91. 7	263, 633	69. 6	195, 418	59. 0	177, 284	53. 5	161, 457	48. 7
Total operating expenses	8, 117, 657	107. 3	8, 204, 492	108. 4	8, 580, 961	113. 4	9, 066, 529	119. 8	9, 659, 982	127. 7
Maintenance: Way and structure	1, 303, 739	109. 4	1, 287, 834	108. 1	1, 405, 132	117. 9	1, 502, 958	126. 1	1, 612, 585	135. 3
Maintenance: Equipment	1, 843, 89	104. 7	1, 867, 789	106. 1	1, 914, 265	108. 8	2, 002, 316	113. 8	2, 165, 254	123. 0
Transportation	4, 139, 268	108. 0	4, 186, 049	109. 2	4, 354, 705	113. 6	4, 595, 574	119. 9	4, 873, 299	127. 1
Operating ratio (percent)	76. 19	95. 8	79. 15	99. 6	79. 05	99. 4	79. 18	99. 6	80. 56	101. 3
Net operating revenue	2, 537, 010	130. 2	2, 161, 549	110. 9	2, 273, 718	116. 7	2, 383, 796	122. 3	2, 331, 676	119. 6
Railway tax accruals	968, 372	97. 0	910, 178	91. 1	946, 334	94. 7	1, 029, 067	103. 0	1, 068, 518	107. 0
Railway operating income	1, 568, 638	165. 1	1, 251, 371	131. 7	1, 327, 384	139. 7	1, 354, 729	142. 5	1, 263, 158	132. 9
Equipment and facility rents	522, 775	142. 8	574, 936	157. 0	649, 760	177. 5	700, 059	191. 2	777, 304	212. 3
Net railway operating income	1, 045, 863	179. 1	676, 434	115. 8	677, 624	116. 0	654, 670	112. 1	485, 854	83. 2
Other income	399, 492	115. 4	457, 545	132. 1	499, 639	144. 3	505, 267	145. 9	482, 433	139. 3
Total income	1, 445, 355	155. 4	1, 133, 980	121. 9	1, 177, 263	126. 5	1, 159, 937	124. 6	968, 787	104. 1
Total fixed charges	425, 804	114. 2	460, 923	123. 6	483, 815	129. 8	521, 346	139. 9	589, 148	158. 1
Income after fixed charges	941, 489	190. 3	588, 774	119. 0	602, 779	121. 8	545, 054	110. 1	256, 851	51. 9
Ordinary income [1]	903, 783	203. 3	553, 789	124. 5	569, 402	128. 1	514, 238	115. 7	226, 583	51. 0
Cash flow	1, 634, 349	137. 1	1, 310, 092	109. 9	1, 363, 132	114. 4	1, 280, 043	107. 4	1, 016, 177	85. 3
Net income			321, 541		564, 505		463, 565		76, 179	
Net railway operating income before Federal income taxes	1, 232, 188	156. 6	742, 752	94. 4	743, 702	94. 5	760, 861	96. 7	574, 204	73. 0
Ordinary income before Federal income taxes	1, 090, 108	168. 3	620, 106	95. 8	635, 480	98. 1	620, 429	95. 8	314, 933	48. 7
Total cash dividends	499, 364	129. 5	502, 872	130. 4	515, 590	133. 7	487, 440	126. 4	421, 226	109. 3

[1] Prior to 1967 reported as net income.

Source: ICC, AAR, Moody's transportation manual.

TABLE A-4.—FINANCIAL SUMMARY, CLASS I RAILROADS, 1960–70

[Dollar amounts in thousands; index, 1960=100]

	1960		1961		1962		1963		1964		1965	
	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index
Net railway operating income	$584, 016	100. 0	$537, 771	92. 1	$725, 679	124. 3	$805, 659	138. 0	$818, 213	140. 1	$961, 516	164. 6
Other income	346, 328	100. 0	322, 281	93. 1	325, 575	94. 0	330, 074	95. 3	368, 891	106. 5	365, 389	105. 5
Total income	930, 344	100. 0	860, 052	92. 4	1, 051, 254	113. 0	1, 135, 733	122. 1	1, 187, 103	127. 6	1, 321, 905	142. 6
Miscellaneous deductions from income	62, 795	100. 0	61, 965	98. 7	71, 733	114. 2	73, 698	117. 4	67, 578	107. 6	70, 633	112. 5
Income available for fixed charges	867, 550	100. 0	798, 087	92. 0	979, 522	112. 9	1, 062, 035	122. 4	1, 119, 526	129. 0	1, 256, 272	144. 8
Fixed charges (total)	372, 751	100. 0	369, 111	99. 0	366, 817	98. 4	367, 970	98. 7	380, 420	102. 1	400, 665	107. 5
Rent for leased road and equity	51, 156	100. 0	47, 993	93. 8	47, 132	92. 1	47, 256	92. 4	50, 867	99. 4	61, 375	120. 0
Interest on funded debt	312, 676	100. 0	314, 084	100. 4	312, 774	100. 0	313, 889	100. 4	322, 385	103. 1	332, 490	106. 3
Interest on unfunded debt	4, 632	100. 0	3, 088	66. 7	3, 046	65. 8	2, 903	62. 7	2, 907	62. 7	2, 269	49. 0
Income after fixed charges	494, 799	100. 0	428, 976	86. 7	612, 705	123. 8	694, 065	140. 3	739, 106	149. 4	855, 607	172. 9
Other deductions (contingent interest)	50, 159	100. 0	46, 532	92. 8	41, 688	83. 1	42, 427	84. 6	40, 922	81. 6	40, 978	81. 7
Ordinary income	444, 640	100. 0	382, 444	86. 0	571, 017	128. 4	651, 637	146. 6	698, 184	157. 0	814, 629	183. 2
Total extraordinary and prior period items												
Total cash dividends	385, 493	100. 0	357, 561	92. 8	368, 164	95. 5	378, 549	98. 2	457, 188	118. 6	470, 800	122. 1
Shareholder's equity	17, 312, 733	100. 0	17, 283, 908	99. 8	17, 559, 195	101. 4	17, 840, 552	103. 0	17, 662, 350	102. 0	17, 746, 696	102. 5
Cash flow (net income plus depreciation)	1, 191, 693	100. 0	1, 073, 155	90. 1	1, 023, 229	85. 9	1, 226, 326	102. 9	1, 383, 824	116. 1	1, 521, 210	127. 6
Current assets	2, 908, 785	100. 0	2, 984, 914	102. 6	3, 034, 983	104. 3	3, 318, 123	114. 1	3, 333, 568	114. 6	3, 183, 339	109. 4
Current liabilities	1, 779, 138	100. 0	1, 978, 862	111. 2	1, 914, 759	107. 6	2, 042, 698	114. 8	2, 153, 647	121. 0	2, 092, 283	117. 6
Net working capital excluding materials and supplies	577, 873	100. 0	510, 927	88. 4	646, 807	111. 9	827, 787	143. 2	730, 771	126. 5	636, 250	110. 1
Average net investment	27, 452, 454	100. 0	27, 319, 990	99. 5	26, 519, 423	96. 6	25, 802, 278	94. 0	25, 881, 046	94. 3	26, 040, 645	94. 9
Interest paid (total)	367, 467	100. 0	363, 704	99. 7	357, 509	97. 3	359, 219	97. 8	366, 214	99. 7	375, 737	102. 2
Fixed interest on funded debt	312, 676	100. 0	314, 084	100. 4	312, 774	100. 0	313, 889	100. 4	322, 385	103. 1	332, 490	106. 3
Fixed interest on unfunded debt	4, 632	100. 0	3, 088	66. 7	3, 046	65. 8	2, 903	62. 7	2, 907	62. 7	2, 269	49. 0
Contingent interest on funded debt	50, 159	100. 0	46, 532	92. 8	41, 689	83. 1	42, 427	84. 6	40, 922	81. 6	40, 978	81. 7

	1966		1967		1968		1969		1970	
	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index
Net railway operating income	$1,045,863	179.1	$676,434	115.8	$677,624	116.0	$654,670	112.1	$485,854	83.2
Other income	399,492	115.4	457,545	132.1	499,639	144.3	505,267	145.9	482,433	139.3
Total income	1,445,355	155.4	1,133,980	121.9	1,177,263	126.5	1,159,937	124.6	968,287	104.1
Miscellaneous deductions from income	78,062	124.3	84,281	134.2	90,669	144.4	93,537	149.0	122,289	194.7
Income available for fixed charges	1,367,293	157.6	1,049,697	121.0	1,086,593	125.2	1,066,400	122.9	845,998	97.5
Fixed charges (total)	425,804	114.2	460,923	123.6	483,815	129.8	521,346	139.9	589,148	158.1
Rent for leased road and equity	60,249	117.8	59,002	115.3	61,588	120.4	60,176	117.6	62,324	121.8
Interest on funded debt	358,736	114.7	393,635	125.9	412,613	132.0	444,330	142.1	496,791	158.9
Interest on unfunded debt	1,736	37.5	3,120	67.4	4,631	100.0	12,278	265.1	25,123	542.4
Income after fixed charges	941,489	190.3	588,774	119.0	602,779	121.8	545,054	110.1	256,851	51.9
Other deductions (contingent interest)	37,706	75.2	34,985	69.8	33,377	66.5	30,817	61.4	30,268	60.3
Ordinary income	903,783	203.3	553,789	124.5	569,402	128.1	514,238	115.7	226,583	51.0
Total extraordinary and prior period items			232,248		4,897		[1] 50,672		[1] 150,404	
Total cash dividends	499,364	129.5	502,872	130.4	515,590	133.7	487,440	126.4	421,226	109.3
Shareholder's equity	18,194,059	105.1	17,973,434	103.8	17,983,820	103.9	17,768,768	102.6	17,323,342	99.9
Cash flow (net income plus depreciation)	1,634,349	137.1	1,310,092	109.9	1,363,132	114.4	1,280,043	107.4	1,016,177	85.3
Current assets	3,256,628	112.0	3,094,223	106.4	3,129,549	107.6	3,378,619	116.1	3,582,546	123.2
Current liabilities	2,279,157	128.1	2,318,943	130.3	2,500,741	140.6	2,819,936	158.5	2,922,740	164.3
Net working capital excluding materials and supplies	477,212	82.6	276,280	47.8	152,720	26.4	56,107	9.7	109,055	18.9
Average net investment	26,820,376	97.7	27,544,828	100.3	27,722,798	101.0	27,735,614	101.0	28,049,714	102.2
Interest paid (total)	398,178	108.4	431,740	117.5	450,621	122.6	487,425	132.6	552,182	150.3
Fixed interest on funded debt	358,736	114.7	393,635	125.9	412,613	132.0	444,330	142.1	496,791	158.9
Fixed interest on unfunded debt	1,736	37.5	3,120	67.4	4,631	100.0	12,278	265.1	25,123	542.4
Contingent interest on funded debt	37,706	75.2	34,985	69.8	33,377	66.5	30,817	61.4	30,268	60.3

[1] Deficit.

Source: ICC, AAR, and Moody's Transportation Manual.

TABLE A-5.—SELECTED FINANCIAL RATIOS, CLASS I RAILROADS, 1960–70

(As a percent; index, 1960=100)

	1960		1961		1962		1963		1964		1965	
	Percent	Index	Percent	Index	Percent	Index	Percent	Index	Percent	Index	Percent	Index
Net operating revenue as a percent of:												
Average net investment	7.1	100.0	7.0	98.6	7.6	107.0	8.2	115.5	8.2	115.5	9.1	128.2
Shareholder's equity	11.3	100.0	11.1	98.2	11.5	101.8	11.8	104.4	12.0	106.2	13.3	107.7
Net railway operating income before Federal income taxes as a percent of:												
Average net investment	2.9	100.0	2.9	100.0	3.3	113.8	3.8	131.0	3.7	127.6	4.3	148.3
Shareholder's equity	4.5	100.0	4.5	100.0	5.0	111.1	5.4	120.0	5.4	120.0	6.3	140.0
Net railway operating income as a percent of:												
Average net investment	2.1	100.0	2.0	95.2	2.7	128.6	3.1	147.6	3.2	152.4	3.7	176.2
Shareholder's equity	3.4	100.0	3.1	90.3	4.1	120.6	4.5	132.4	4.6	135.3	5.4	158.8
Ordinary income as a percent of:												
Average net investment	1.6	100.0	1.4	87.5	2.2	137.5	2.5	156.2	2.7	168.8	3.1	193.8
Shareholder's equity	2.6	100.0	2.2	84.6	3.2	123.1	3.6	138.5	4.0	153.8	4.6	176.9
Cash flow as a percent of:												
Average net investment	4.3	100.0	3.9	90.7	3.9	90.7	4.7	109.3	5.3	123.3	5.8	134.9
Shareholder's equity	6.9	100.0	6.2	89.9	5.8	84.1	6.9	100.0	7.8	113.0	8.6	124.6
Cash dividends as a percent of:												
Net operating revenue	19.8	100.0	18.7	94.4	18.2	91.9	18.0	90.9	21.6	109.1	20.0	101.0
Net railroad operating income	66.0	100.0	66.5	100.8	50.7	76.8	47.0	71.2	55.9	84.7	49.0	74.2
Ordinary income	86.7	100.0	93.5	107.8	64.5	74.4	58.1	67.0	65.5	75.6	57.8	66.7
Cash flow	32.3	100.0	33.3	103.1	36.0	111.5	30.9	95.7	33.0	102.2	30.9	95.7
Net working capital excluding materials and supplies	66.7	100.0	70.0	104.9	56.9	85.3	45.7	68.5	62.6	93.9	74.0	110.9
Debt due within 1 year as a percent of net working capital	78.2	100.0	77.1	98.6	65.8	84.1	54.6	69.8	62.2	79.5	72.9	93.2
Other income as a percent of:												
Net operating revenue	17.8	100.0	16.8	94.4	16.1	90.4	15.7	88.2	17.4	97.8	15.5	87.1
Net railroad operating income	59.3	100.0	60.0	101.2	44.9	75.7	41.0	69.1	45.1	76.8	38.0	64.1
Ordinary income	77.9	100.0	84.3	108.2	57.0	73.2	50.6	65.0	52.8	67.0	44.8	57.5
Fixed charges as a percent of:												
Pretax ordinary income	57.6	100.0	59.1	102.6	50.4	87.5	45.1	78.3	45.5	79.0	40.9	71.0
Net working capital	64.5	100.0	72.2	111.9	56.7	87.9	44.4	68.8	52.1	80.1	63.0	97.7

	1966		1967		1968		1969		1970	
	Percent	Index	Percent	Index	Percent	Index	Percent	Index	Percent	Index
Net operating revenue as a percent of:										
Average net investment	9.5	133.8	7.8	109.9	8.2	115.5	8.6	121.1	8.3	116.9
Shareholder's equity	13.9	123.0	12.0	106.2	12.6	111.5	13.4	118.6	13.5	119.5
Net railway operating income before Federal income taxes as a percent of:										
Average net investment	4.6	158.6	2.7	93.1	2.7	93.1	2.7	93.1	2.0	69.0
Shareholder's equity	6.8	151.1	4.1	91.1	4.1	91.1	4.3	95.6	3.3	73.2
Net railway operating income as a percent of:										
Average net investment	3.9	185.7	2.5	119.0	2.4	114.3	2.4	114.3	1.7	81.0
Shareholder's equity	5.7	167.6	3.8	111.8	3.8	111.8	3.7	108.8	2.8	82.4
Ordinary income as a percent of:										
Average net investment	3.4	212.5	2.0	125.0	2.0	125.0	1.8	112.5	0.8	50.0
Shareholder's equity	5.0	192.3	3.1	119.2	3.2	123.1	2.9	111.5	1.3	50.0
Cash flow as a percent of:										
Average net investment	6.1	141.9	4.8	111.6	4.9	113.9	4.6	107.0	3.6	83.7
Shareholder's equity	9.0	130.4	7.3	105.8	7.6	110.1	7.2	104.3	5.9	85.5
Cash dividends as a percent of:										
Net operating revenue	19.7	99.5	23.3	117.7	22.7	114.6	20.4	103.0	18.1	91.4
Net railroad operating income	47.7	72.3	74.3	112.6	76.1	115.3	74.5	112.9	86.7	131.4
Ordinary income	55.2	63.7	90.8	104.7	90.5	104.4	94.8	109.3	185.9	214.4
Cash flow	30.5	94.4	38.4	118.9	37.8	117.0	38.1	118.0	41.4	128.2
Net working capital excluding materials and supplies	104.6	156.8	182.0	272.9	337.6	506.1	868.8	1,302.5	386.2	579.0
Debt due within 1 year as a percent of: net working capital	110.9	141.8	189.9	242.8	402.9	515.2	1,325.2	1,694.6	551.3	705.0
Other income as a percent of:										
Net operating revenue	15.7	88.2	21.2	119.1	22.0	123.6	21.2	119.1	20.7	116.3
Net railroad operating income	38.2	64.4	67.6	114.0	73.7	124.3	77.2	130.2	99.3	167.4
Ordinary income	44.2	56.7	82.6	106.0	87.7	112.6	98.3	126.2	212.9	273.3
Fixed charges as a percent of:										
Pretax ordinary income	39.1	67.9	74.3	129.0	76.1	132.1	84.0	145.8	187.1	324.8
Net working capital	89.2	138.3	166.8	258.6	316.8	491.2	929.2	1,440.6	540.2	937.5

Source: ICC and AAR.

TABLE A-6.—OPERATING REVENUE, CLASS I RAILROADS, REGIONAL DISTRICTS, AND SELECTED RAILROADS, 1960–70

[Dollar amounts in thousands; 1960=100]

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroad	$9, 514, 294	$9, 189, 138	$9, 439, 895	$9, 559, 522	$9, 856, 527	$10, 207, 850	$10, 654, 666	$10, 366, 041	$10, 854, 678	$11, 450, 325	$11, 983, 459
Index	100. 0	96. 6	99. 2	100. 5	103. 6	107. 3	112. 0	108. 9	114. 1	120. 3	125. 9
Eastern district	$3, 932, 638	$3, 694, 133	$3, 802, 588	$3, 849, 103	$3, 980, 210	$4, 124, 802	$4, 211, 027	4, 083, 959	$4, 242, 730	$4, 366, 467	$4, 540, 973
Index	100. 0	93. 7	96. 7	97. 9	101. 2	104. 9	107. 1	103. 8	107. 9	111. 0	115. 5
Penn Central [1]	$1, 518, 248	$1, 432, 145	$1, 473, 214	$1, 463, 445	$1, 514, 760	$1, 554, 008	$1, 577, 885	$1, 509, 831	$1, 516, 237	$1, 651, 978	$1, 691, 086
Index	100. 0	94. 3	97. 0	92. 4	99. 8	102. 4	103. 9	99. 5	99. 9	108. 8	111. 4
Norfolk & Western [2]	$510, 836	$490, 652	$507, 494	$530, 515	$558, 206	$592, 493	$613, 985	$594, 178	$641, 839	$681, 043	$734, 218
Index	100. 0	96. 1	99. 4	103. 8	109. 3	116. 0	120. 2	116. 3	125. 6	133. 3	143. 7
Southern district	$1, 359, 012	$1, 347, 064	$1, 410, 390	$1, 432, 834	$1, 481, 912	$1, 527, 035	$1, 612, 804	$1, 623, 199	$1, 716, 265	$1, 880, 771	$2, 002, 676
Index	100. 0	99. 1	103. 9	105. 4	109. 0	112. 4	118. 7	119. 4	126. 3	138. 4	147. 4
Southern Railway	$261, 060	$260, 094	$271, 040	$278, 314	$291, 913	$303, 218	$316, 335	$314, 770	$342, 433	$378, 361	$400, 058
Index	100. 0	99. 6	103. 8	106. 6	111. 8	116. 1	121. 2	120. 6	131. 2	144. 9	153. 2
Illinois Central	$260, 225	$252, 142	$268, 201	$274, 676	$273, 682	$282, 524	$295, 989	$299, 152	$304, 571	$322, 700	$338, 090
Index	100. 0	96. 9	103. 1	105. 5	105. 2	108. 6	113. 7	115. 0	117. 0	124. 0	129. 9
Western District	$4, 222, 644	$4, 147, 941	$4, 226, 917	$4, 277, 585	$4, 394, 404	$4, 556, 012	$4, 830, 835	$4, 658, 883	$4, 895, 684	$5, 203, 087	$5, 439, 809
Index	100. 0	98. 2	100. 1	101. 3	104. 1	108. 0	114. 4	110. 3	115. 9	123. 2	128. 8
Southern Pacific	$666, 632	$674, 813	$701, 879	$704, 488	$728, 578	$786, 296	$822, 355	$799, 309	$860, 168	$923, 922	$935, 702
Index	100. 0	101. 2	105. 3	105. 7	109. 3	117. 9	123. 4	119. 9	129. 0	138. 6	140. 4
Union Pacific	$494, 184	$499, 324	$512, 125	$519, 104	$529, 079	$549, 190	$589. 138	$574, 020	$595, 031	$630, 407	$669. 617
Index	100. 0	101. 0	103. 6	105. 0	107. 1	111. 1	119. 2	116. 1	120. 4	127. 6	135. 5

[1] 1960–67 Pro forma.
[2] 1960–64 pro forma.

Source: Class I railroads and regional districts, ICC and AAR; selected railroads, Moody's Transportation Manual.

TABLE A-7.—OPERATING EXPENSES, CLASS I RAILROADS, REGIONAL DISTRICTS, AND SELECTED RAILROADS, 1960–70

[Dollar amounts in thousands; 1960=100]

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroads	$7, 565, 336	$7, 274, 260	$7, 418, 562	$7, 451, 648	$7, 737, 847	$7, 849, 841	$8, 117, 657	$8, 204, 492	$8, 580, 961	$9, 066, 529	$9, 659, 982
Index	100.0	96.2	98.1	98.5	102.3	103.8	107.3	108.4	113.4	119.8	127.7
Eastern District	$3, 199, 432	$3, 054, 789	$3, 068, 616	$3, 054, 248	$3, 143, 281	$3, 173, 682	$3, 240, 325	$3, 278, 521	$3, 416, 203	$3, 545, 001	$3, 853, 523
Index	100.0	95.5	95.9	95.5	98.3	99.2	101.3	102.5	106.8	110.8	120.4
Penn Central [1]	$1, 266, 285	$1, 195, 216	$1, 214, 968	$1, 194, 374	$1, 221, 810	$1, 227, 730	$1, 243, 078	$1, 233, 336	$1, 267, 896	$1, 414, 162	$1, 557, 104
Index	100.0	94.4	96.0	94.3	96.5	97.0	98.2	97.4	100.1	111.7	123.0
Norfolk & Western [2]	$347, 259	$331, 080	$339, 002	$347, 613	$371, 094	$390, 725	$410, 781	$416, 138	$447, 599	$476, 383	$528, 802
Index	100.0	95.3	97.6	100.1	106.9	112.5	118.3	119.8	128.9	137.2	152.3
Southern District	$1, 070, 127	$1, 036, 576	$1, 079, 711	$1, 100, 832	$1, 152, 650	$1, 170, 391	$1, 205, 708	$1, 240, 538	$1, 310, 917	$1, 424, 654	$1, 516, 765
Index	100.0	96.9	100.9	102.9	107.7	109.4	112.7	115.9	122.5	133.1	141.7
Southern Railway	$182, 631	$184, 197	$187, 410	$193, 520	$201, 965	$214, 946	$215, 213	$215, 326	$239, 527	$264, 664	$291, 413
Index	100.0	100.9	102.6	106.0	110.6	117.7	117.8	117.9	131.1	144.9	159.6
Illinois Central	$211, 149	$199, 494	$209, 638	$214, 502	$222, 155	$222, 317	$231, 420	$232, 364	$243, 164	$225, 608	$267, 062
Index	100.0	94.5	99.3	101.6	105.2	105.3	109.6	110.0	115.2	121.1	126.5
Western District	$3, 295, 777	$3, 182, 895	$3, 270, 234	$3, 296, 567	$3, 441, 916	$3, 505, 767	$3, 671, 624	$3, 685, 433	$3, 853, 840	$4, 096, 873	$4, 289, 694
Index	100.0	96.6	99.2	100.0	104.4	106.4	111.4	111.8	116.9	124.3	130.2
Southern Pacific	$527, 213	$522, 144	$548, 759	$553, 260	$528, 287	$611, 711	$641, 468	$626, 185	$672, 008	$719, 317	$731, 402
Index	100.0	99.0	104.1	104.9	100.2	116.0	121.7	118.8	127.5	136.4	138.7
Union Pacific	$359, 741	$360, 799	$370, 157	$372, 132	$395, 192	$403, 683	$425, 002	$428, 966	$450, 001	$477, 072	$502, 753
Index	100.0	100.3	102.9	103.4	109.8	112.2	118.1	119.2	125.1	132.6	139.7

[1] 1960–67 Pro forma.
[2] 1960–1964 Pro forma.

Source: Class I railroads and regional districts, ICC and AAR; selected railroads, Moody's Transportation Manual.

TABLE A-8.—EQUIPMENT AND JOINT FACILITIES RENT AS A PERCENT OF NET OPERATING REVENUE, REGIONAL DISTRICTS AND SELECTED RAILROADS, 1964-70

Year	1964	1965	1966	1967	1968	1969	1970
Eastern District	36.7	25.4	25.4	36.4	40.4	42.2	56.3
Penn Central [1]	39.3	38.9	37.1	52.1	68.2	77.3	(2)
Norfolk & Western [3]	6.6	8.2	8.5	17.4	15.8	16.2	17.4
Southern District	10.4	17.8	19.6	21.0	23.8	20.1	20.9
Southern Railway	8.6	8.8	8.0	7.7	7.7	6.8	7.0
Illinois Central	28.9	23.3	22.6	26.3	30.6	27.2	29.1
Western District	16.9	16.6	17.1	20.6	21.1	23.7	24.9
Southern Pacific	20.1	22.5	24.0	25.7	28.3	27.5	30.7
Union Pacific	13.0	8.4	6.5	3.3	2.0	2.9	(4)

[1] 1964-67 pro forma.
[2] Over 100 percent.
[3] 1964 pro forma.
[4] Facilities and equipment rents is a credit amount.

Source: Moody's Transportation Manual.

TABLE A-9.—ANNUAL FIXED CHARGES AS A PERCENT OF NET RAILWAY OPERATING INCOME, CLASS I RAILROADS, 1960-70

Year	Percent	Year	Percent
1960	63.8	1966	40.7
1961	68.6	1967	68.1
1962	50.5	1968	7.14
1963	45.7	1969	79.6
1964	46.5	1970	(1)
1965	41.7		

[1] Over 100 percent.

Source: ICC and AAR.

TABLE A-10.—OTHER INCOME AS A PERCENT OF PRE-FEDERAL INCOME TAX ORDINARY INCOME [1], CLASS I RAILROADS, 1960-70

Year	Percent	Year	Percent
1960	53.5	1966	36.7
1961	51.6	1967	73.8
1962	44.7	1968	79.3
1963	40.5	1969	81.4
1964	44.1	1970	(2)
1965	37.3		

[1] Before 1967 reported as Net Income.
[2] Over 100 percent.

Source: ICC and AAR.

TABLE A-11.—OTHER INCOME AS A PERCENT OF PRE-FEDERAL INCOME TAX ORDINARY INCOME,[1] REGIONAL DISTRICTS AND SELECTED RAILROADS, 1964-70

	Year						
	1964	1965	1966	1967	1968	1969	1970
Eastern district	(2)	43.5	47.2	(2)	(2)	(2)	(3)
Penn Central [4]	(2)	99.7	90.6	(2)	(3)	(3)	(3)
Norfolk & Western [5]	9.4	8.6	11.6	19.6	22.3	21.2	18.9
Southern district	20.2	29.7	27.5	39.6	42.3	36.6	42.4
Southern Railway	10.6	19.5	15.6	19.5	19.4	16.0	26.5
Illinois Central	33.2	17.8	22.6	33.8	44.8	41.1	70.4
Western district	42.3	35.9	33.5	58.2	57.5	57.3	65.9
Southern Pacific	49.1	44.0	53.1	62.6	58.7	55.8	74.4
Union Pacific	50.1	38.4	34.7	44.4	50.6	51.6	57.4

[1] Before 1967 reported as net income.
[2] Over 100 percent.
[3] Not calculated because pre-Federal income tax ordinary income is a deficit amount.
[4] 1964-67 pro forma.
[5] 1964 pro forma.

Source: Moody's Transportation Manual.

TABLE A-12.—CASH FLOW[1] CLASS I RAILROADS AND SELECTED RAILROADS, 1960–70

[Dollar amounts in thousands; index: 1960=100]

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroads	$1,191,693	$1,073,155	$1,023,229	$1,226,326	$1,383,824	$1,521,210	$1,634,349	$1,310,092	$1,363,132	$1,280,043	$1,016,177
Index	100.0	90.1	85.9	102.9	116.1	127.6	137.1	109.9	114.4	107.4	85.3
Penn Central [2]	$89,277	$85,534	$86,118	$108,235	$145,169	$167,441	$144,833	$109,878	$91,363	$11,604	[3] $230,963
Index	100.0	95.8	96.5	121.2	162.6	187.5	162.2	123.1	102.3	13.0	(4)
Pennsylvania	$46,248	$57,058	$49,914	$61,354	$79,328	$84,951	$98,439	$68,068			
New York Central	$43,029	$28,476	$36,204	$46,881	$65,841	$82,490	$46,394	$41,810			
Norfolk A Western [5]	$107,325	$104,682	$112,201	$117,845	$122,477	$134,964	$144,335	$123,697	$128,432	$137,488	$136,360
Index	100.0	97.5	104.5	109.8	114.1	125.7	134.5	115.2	119.7	128.1	127.0
Southern Railway	$47,032	$46,450	$52,434	$52,064	$55,325	$54,405	$54,872	$61,397	$57,660	$71,151	$76,730
Index	100.0	98.8	111.5	110.7	117.6	115.7	116.7	130.5	122.6	151.3	163.1
Illinois Central	$26,019	$28,313	$35,590	$37,516	$32,417	$37,281	$42,065	$45,652	$47,703	$48,830	$45,762
Index	100.0	108.8	136.8	144.2	124.6	143.4	161.7	175.5	183.3	187.7	175.9
Southern Pacific	$92,067	$96,686	$111,117	$118,835	$119,630	$128,951	$136,061	$118,909	$139,819	$146,111	$137,492
Index	100.0	105.0	120.7	129.1	129.9	140.1	147.8	129.1	151.9	158.7	149.3
Union Pacific	$100,849	$105,702	$121,593	$125,818	$128,543	$139,784	$160,598	$156,705	$157,795	$159,720	$182,548
Index	100.0	104.8	120.6	124.8	127.5	138.6	159.2	155.4	156.5	158.4	181.0

[1] Net income plus depreciation (not including depreciation of shop and power plant machinery).
[2] 1960–67, pro forma.
[3] Deficit.
[4] Not caculated because of deficit in cash flow.
[5] 1960–64, pro forma.

Source: Moody's Transportation Manual.

	1960				1961				1962				1963			
	Ordinary income		Cash flow		Ordinary income		Cash flow		Ordinary income		Cash flow		Ordinary income		Cash flow	
	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index
Class I railroads	$444,640	100	$1,191,693	100	$382,444	86.0	$1,073,155	90.1	$571,017	128.4	$1,023,229	85.9	$651,637	146.6	$1,226,326	102.9
Penn Central [1]	[2] 6,781	(3)	89,277	100	[2] 9,033	(3)	85,534	95.8	[2] 7,046	(3)	86,118	96.5	16,199	(3)	108,235	121.2
Norfolk & Western [4]	69,637	100	107,325	100	66,317	95.2	104,682	97.5	73,594	105.7	112,201	104.5	77,605	111.4	117,845	109.8
Southern Railway	30,703	100	47,032	100	29,435	95.9	46,450	98.8	34,740	113.1	52,434	111.5	33,039	107.6	52,065	110.7
Illinois Central	11,093	100	26,019	100	12,715	114.6	28,313	108.8	19,623	176.9	35,590	136.8	20,917	188.6	37,516	144.2
Southern Pacific	47,445	100	92,067	100	54,552	115.0	96,686	105.0	60,783	128.1	111,117	120.7	67,053	141.3	118,835	129.1
Union Pacific	65,313	100	100,849	100	67,670	103.6	105,702	104.8	82,490	126.3	121,593	120.6	84,222	129.0	125,818	124.8

TABLE A-13.—ORDINARY INCOME* AND CASH FLOW, CLASS I RAILROADS, 1960–70

[Dollar amounts in thousands; index, 1960=100]

	1964				1965				1966				1967			
	Ordinary income		Cash flow		Ordinary income		Cash flow		Ordinary income		Cash flow		Ordinary income		Cash flow	
	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index	Amount	Index
Class I Railroads	$694,184	157.0	$1,383,824	116.1	$814,629	183.2	$1,521,210	127.6	$903,783	203.3	$1,634,349	137.1	$553,789	124.5	$310,092	109.9
Penn Central [1]	56,180	([4])	145,169	162.6	75,416	([4])	167,441	187.5	95,167	([4])	144,833	162.2	15,325	([4])	109,878	123.1
Norfolk & Western [4]	80,089	115.0	122,477	114.1	90,056	129.3	134,964	125.7	97,823	140.5	144,335	134.5	72,607	104.3	23,697	115.2
Southern Railway	35,418	115.4	55,325	117.6	33,371	108.7	54,405	115.7	33,855	110.3	54,872	116.7	39,494	128.6	61,397	130.5
Illinois Central	15,727	141.8	32,417	124.6	19,447	175.3	37,281	143.4	23,341	210.4	42,065	161.7	25,364	228.6	45,652	175.5
Southern Pacific	63,898	134.7	119,630	129.9	69,677	146.9	128,951	140.1	74,392	156.8	136,061	147.8	54,717	115.3	118,909	129.1
Union Pacific	85,464	130.8	128,543	127.5	93,755	143.5	139,784	138.6	109,792	168.1	160,598	159.2	102,133	156.4	156,705	155.4

	1968				1969				1970			
	Ordinary income		Cash flow		Ordinary income		Cash flow		Ordinary income		Cash flow	
	Amount	Index	Amount	Index	Amount	Amount	Index	Index	Amount	Index	Amount	Index
Class I Railroads	$569,402	128.1	$1,363,132	114.4	$514,238	115.7	$1,280,043	107.4	$226,583	51.0	$1,016,177	85.3
Penn Central [1]	[2] 2,773	([4])	91,363	102.3	[2] 82,814	([4])	11,604	13.0	[2] 325,739	([4])	[2] 230,963	([3])
Norfolk & Western [4]	74,141	106.5	128,432	119.7	80,225	115.2	137,488	128.1	76,184	109.4	136,360	127.0
Southern Railway	34,143	111.2	57,660	122.6	42,536	138.5	71,151	151.3	46,579	151.7	76,730	163.1
Illinois Central	26,143	235.7	47,703	183.3	26,520	239.1	48,830	187.7	23,806	214.6	45,762	175.9
Southern Pacific	74,860	157.8	139,819	151.9	77,559	163.5	146,111	158.7	66,410	140.0	137,492	149.3
Union Pacific	102,734	157.3	157,795	156.5	103,794	158.9	159,720	158.4	123,041	188.4	182,548	181.0

*Reported as net income prior to 1967.

[1] 1960–67 pro forma.
[2] Deficit.
[3] Not calculated because of deficit.
[4] 1960–64 pro forma.

Source: Moody's Transportation Manual.

TABLE A-14.—FIXED CHARGES AS A PERCENT OF CASH FLOW, CLASS I RAILROADS AND SELECTED RAILROADS, 1964-70

	1964	1965	1966	1967	1968	1969	1970
Class I railroads	27.5	26.3	26.0	35.2	35.5	40.7	58.0
Penn Central [1]	51.6	46.8	54.7	77.1	(2)	(2)	(3)
Norfolk & Western [4]	24.1	23.5	26.6	32.9	24.3	34.8	34.3
Southern Railway	25.0	27.5	27.4	26.8	31.4	30.5	31.8
Slinois Central	20.3	17.4	16.8	17.0	21.1	22.6	27.6
Ilouthern Pacific	22.9	22.3	22.1	26.6	22.6	22.8	26.8
Union Pacific	2.9	2.5	3.5	6.5	7.0	7.3	14.3

[1] 1964-67 pro forma.
[2] Over 100 percent.
[3] Not calculated because cash flow is a deficit amount.
[4] 1964 pro forma.

Source: Moody's Transportation Manual.

TABLE A-15.—CASH FLOW AS A PERCENT OF NET WORTH, CLASS I RAILROADS AND SELECTED RAILROADS, 1964-70

	1964	1965	1966	1967	1968	1969	1970
Class I Railroad	7.8	8.6	9.0	7.3	7.6	7.2	5.9
Penn Central [1]	(2)	7.1	6.0	5.2	4.5	0.6	(3)
Norfolk & Western [4]	7.6	7.9	7.8	6.5	6.4	6.6	6.2
Southern Railway	9.4	9.1	8.9	9.8	9.0	11.0	11.0
Illinois Central	7.1	8.0	7.8	8.2	8.2	8.2	7.5
Southern Pacific	8.6	9.1	9.4	8.2	9.4	9.8	9.3
Union Pacific	8.8	9.3	10.2	9.7	9.4	9.2	10.1

[1] 1964-1967 pro forma.
[2] Not available.
[3] Not calculated because Cash Flow is a deficit amount.
[4] 1964 pro forma.

Source: Moody's Transportation Manual.

TABLE A-16.—CASH DIVIDENDS AS A PERCENT OF PRE-FEDERAL INCOME TAX ORDINARY INCOME [1] AND AS A PERCENT OF CASH FLOW, CLASS I RAILROADS, 1960-70

Year	Percent of pre-FIT ordinary income	Percent of cash flow
1960	59.5	32.3
1961	57.2	33.3
1962	50.6	36.0
1963	46.4	30.9
1964	54.7	33.0
1965	48.1	30.9
1966	45.8	27.5
1967	81.1	38.4
1968	78.5	37.8
1969	78.6	38.1
1970	(2)	41.4

[1] Before 1967 reported as net income.
[2] Over 100 percent.

Source: ICC and AAR.

TABLE A-17.—CASH DIVIDENDS AS A PERCENT OF PRE-FEDERAL INCOME TAX, ORDINARY INCOME,[1] SELECTED RAILROADS 1964-70

	1964	1965	1966	1967	1968	1969	1970
Penn Central [2]	54.5	67.0	66.6	(3)	(4)	(4)	(4)
Norfolk & Western [5]	47.6	51.9	52.5	75.3	65.4	66.9	70.4
Southern Railway	45.4	51.8	48.5	44.6	50.3	37.3	47.6
Illinois Central	42.3	31.7	29.8	32.7	34.6	36.2	42.0
Southern Pacific	55.4	48.6	45.6	64.9	56.9	57.2	94.3
Union Pacific	39.6	36.6	35.8	42.5	41.4	39.3	38.4

[1] Before 1967 reported as Net Income.
[2] 1964-67 pro forma.
[3] Over 100 percent.
[4] Not calculated because pre-Federal Income Tax Ordinary Income is a deficit amount.
[5] 1964 pro forma.

Source: Moody's Transportation Manual.

TABLE A-18.—CURRENT ASSETS AS A PERCENT OF CURRENT LIABILITIES,[1] CLASS I RAILROADS, 1960-70

Year	Percent	Year	Percent
1960	163.5	1966	142.9
1961	150.8	1967	133.4
1962	158.5	1968	125.1
1963	162.4	1969	119.8
1964	154.8	1970	122.6
1965	152.1		

[1] Excluding long term debt due within 1 year.

Source: ICC and AAR.

TABLE A-19.—CURRENT ASSETS AS A PERCENT OF CURRENT LIABILITIES,[1] SELECTED RAILROADS, 1964-70

	1964	1965	1966	1967	1968	1969	1970
Penn Central[2]	113.4	125.2	125.5	110.0	86.4	98.8	126.6
Norfolk & Western[3]	164.1	157.0	158.3	151.4	145.4	131.2	126.6
Southern Railway	125.9	127.8	124.9	137.9	129.4	129.2	115.3
Illinois Central	136.1	129.1	123.5	141.2	137.0	161.2	150.1
Southern Pacific	177.2	147.0	128.2	120.1	126.7	103.3	122.3
Union Pacific	286.6	230.0	234.4	199.3	187.7	133.6	139.6

[1] Excluding long-term debt due within 1 year.
[2] 1964-67 pro forma.
[3] 1964 pro forma.

Source: Moody's Transportation Manual.

TABLE A-20.—DEBT DUE WITHIN 1 YEAR AS A PERCENT OF PRE-FEDERAL INCOME TAX ORDINARY INCOME,[1] SELECTED RAILROADS, 1964-70

	1964	1965	1966	1967	1968	1969	1970
Penn Central[4]	(3)	(4)	93.9	(4)	(5)	(5)	(5)
Norfolk & Western[6]	18.0	22.9	40.1	61.1	57.0	70.1	79.5
Southern Railway	56.1	35.6	34.2	29.8	54.7	37.5	53.9
Illinois Central	52.3	36.9	35.4	33.8	56.8	55.8	59.9
Southern Pacific	62.0	49.0	41.3	71.7	90.1	55.1	62.4
Union Pacific	3.2	3.0	13.3	18.3	21.4	24.8	17.3

[1] Before 1967 reported as net income.
[2] 1964-67 pro forma.
[3] Not available.
[4] Over 100 percent.
[5] Not calculated because pre-Federal income tax ordinary income is debt amount.
[6] 1964 pro forma.

Source: Moody's Transportation Manual.

TABLE A-21.—NET WORKING CAPITAL[1] AS A PERCENT OF FIXED CHARGES, CLASS I RAILROADS, 1960-70

Year	Percent	Year	Percent
1960	155.0	1966	112.1
1961	138.4	1967	59.9
1962	176.3	1968	31.6
1963	225.0	1969	10.8
1964	192.1	1970	18.5
1965	61.2		

[1] Excluding materials and supplies and long term debt due within 1 year.

Source: I.C.C. and AAR.

TABLE A-22.—NET WORKING CAPITAL[1] AS A PERCENT OF FIXED CHARGES, SELECTED RAILROADS 1964-70

Year	1964	1965	1966	1967	1968	1969	1970
Penn Central[2]	(3)	(3)	(3)	(4)	(3)	(3)	17.7
Norfolk & Western[4]	224.1	179.1	122.6	83.5	80.6	28.9	29.6
Southern Railway	69.2	75.9	63.9	121.2	101.6	79.1	1.,
Illinois Central	146.2	56.9	20.1	149.7	121.0	249.7	209.7
Southern Pacific	375.4	232.1	123.6	71.0	120.5	(3)	80.6
Union Pacific	(5)	(5)	(5)	976.5	812.6	450.6	288.5

[1] Excluding materials and supplies and debt due within 1 year.
[2] 1964-67 pro forma.
[3] Not calculated because net working capital is a deficit amount.
[4] 1964 pro forma.
[5] Over 1,000 percent.

Source: Moody's Transportation manual.

TABLE A-23.—STATE AND LOCAL TAXES AS A PERCENT OF PRE-FEDERAL INCOME TAX ORDINARY INCOME[1] CLASS I RAILROADS 1960-70

Year	Percent	Year	Percent
1960	61.2	1966	31.1
1961	60.9	1967	58.5
1962	50.0	1968	55.4
1963	42.2	1969	62.1
1964	41.1	1970	(2)
1965	36.1		

[1] Before 1967 reported as net income.
[2] Over 100 percent.

Source: ICC and AAR.

TABLE A-24.—STATE AND LOCAL TAXES[1] AS A PERCENT OF PRE-FEDERAL INCOME TAX ORDINARY INCOME,[2] SELECTED RAILROADS, 1964-70

	1964	1965	1966	1967	1968	1969	1970
Penn Central [3]	87.3	70.9	52.8	(4)	(5)	(5)	(5)
Norfolk & Western [6]	20.7	20.2	18.8	29.2	27.4	30.9	35.5
Southern Railway	25.0	28.5	28.1	24.5	28.3	21.7	24.0
Illinois Central	59.1	47.2	40.2	37.7	42.3	41.5	48.6
Southern Pacific	45.5	40.9	38.7	58.9	44.2	44.2	57.8
Union Pacific	18.4	16.9	15.5	17.4	18.4	17.8	18.7

[1] Includes foreign taxes as well as U.S. Government taxes other than payroll and income taxes.
[2] Before 1967 reported as net income.
[3] 1964–67 pro forma.
[4] Over 100 percent.
[5] Not calculated because pre-Federal income tax ordinary income is a deficit amount.
[6] 1964 pro forma.

Source ICC and AAR.

TABLE A-25.—OUTPUT PER MAN-HOUR, UNIT LABOR REQUIREMENTS, AND RELATED DATA, CLASS I RAILROADS, 1939–70 [1]

Year	All employees, 1939–70 (Indexes, 1967=100)							Production workers, 1939–70 (Indexes, 1967=100)						
	Output per—		Unit labor requirements in terms of—		Related data			Output per—		Unit labor requirements in trrms of—		Related data		
	Employee	Man-hour	Employees	Man-hours	Output	Employees	Man-hours	Production worker	Production worker man-hour	Production workers	Production worker man-hours	Output [2]	Production workers	Production worker man-hours
1939	31.4	27.9	318.0	358.4	50.5	160.6	181.0	30.5	27.2	328.1	367.7	50.5	165.7	185.7
1947	45.2	38.3	221.3	261.1	99.6	220.4	260.1	43.2	36.7	231.5	272.8	99.6	230.6	271.7
1948	44.4	37.6	225.3	265.7	96.1	216.5	255.3	42.5	36.1	235.5	277.1	96.1	226.3	266.3
1949	40.8	36.7	245.0	272.4	79.6	195.0	216.8	39.3	35.5	254.4	281.8	79.6	202.5	224.3
1950	43.6	42.0	229.6	238.3	87.1	200.0	207.6	41.9	40.4	238.9	247.3	87.1	208.1	215.4
1951	45.7	44.4	218.8	225.1	95.6	209.2	215.2	43.8	42.7	228.5	234.0	95.6	218.4	223.7
1952	45.3	44.6	220.9	224.5	91.2	201.5	204.7	43.5	43.0	229.9	232.6	91.2	209.7	212.1
1953	45.1	44.8	221.7	223.3	89.4	198.2	199.6	43.4	43.3	230.5	231.0	89.4	206.1	206.5
1954	46.3	46.6	215.8	214.5	81.2	175.2	174.2	44.9	45.4	222.5	220.1	81.2	180.7	178.7
1955	52.2	51.6	191.4	194.0	91.0	174.2	176.5	50.6	50.2	197.7	199.0	91.0	179.9	181.1
1956	54.6	54.0	183.2	185.1	94.1	172.4	174.2	52.9	52.7	189.1	189.6	94.1	177.9	178.4
1957	54.8	54.8	182.5	182.5	89.6	163.5	163.5	53.3	53.7	187.7	186.3	89.6	168.2	166.9
1958	57.5	57.6	173.9	173.5	80.1	139.3	139.0	56.4	57.1	177.2	175.3	80.1	141.9	140.4
1959	61.3	61.2	163.1	163.4	82.9	135.2	135.5	60.2	60.6	166.0	164.9	82.9	137.6	136.7
1960	63.5	63.6	157.5	157.2	82.2	129.5	129.2	62.5	63.2	160.1	158.2	82.2	131.6	130.0
1961	67.9	68.2	147.3	146.7	80.8	119.0	118.5	67.1	68.1	149.0	146.8	80.8	120.4	118.6
1962	73.0	72.6	137.1	137.7	84.7	116.1	116.6	72.2	72.4	138.5	138.1	84.7	117.3	117.0
1963	78.2	77.1	127.9	129.6	88.1	112.7	114.2	77.3	76.9	129.3	130.0	88.1	113.9	114.5
1964	84.4	82.1	118.5	121.7	92.9	110.1	113.1	83.5	81.9	119.7	122.2	92.9	111.2	113.5
1965	92.9	90.8	107.7	110.1	97.8	105.3	107.7	92.3	91.0	108.4	109.9	97.8	106.0	107.5
1966	99.6	97.5	100.4	102.5	103.1	103.5	105.7	99.2	97.6	100.8	102.4	103.1	103.9	105.6
1967	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1968	105.9	104.4	94.4	95.8	102.5	96.8	98.2	106.0	104.4	94.3	95.8	102.5	96.7	98.2
1969	111.1	109.2	90.0	91.6	105.4	94.9	96.5	111.4	109.3	89.8	91.5	105.4	94.6	96.4
1970 [3]	111.9	109.7	89.3	91.2	104.2	93.1	95.0	112.6	109.9	88.8	91.0	104.2	92.5	94.8
Average annual rates (percent):														
1947–70	4.8	5.2	−4.6	−5.0	.5	−4.1	−4.5	5.1	5.5	−4.8	−5.2	.5	−4.4	−4.7
1957–70	6.2	6.0	−5.8	−5.7	2.2	−3.7	−3.6	6.4	6.1	−6.0	−5.8	2.2	−4.0	−3.7

[1] Class I railroads and class I switching and terminal companies.

[2] The measures of output used in this table represent the total production of the industry resulting from all employees and do not represent the specific output of any single group of employees.

[3] Preliminary.

Source: Department of Labor, BLS Bulletin 1692, table 100 and 101.

TABLE A-26.—AVERAGE LENGTH OF HAUL IN MILES, NATIONAL RAIL SYSTEM AND SELECTED RAILROADS, 1961-70

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I national system	452	461	464	466	477	484	485	495	497	499
Penn Central								303	294	298
Pennsylvania	275	281	282	287	292	291	289			
New York Central	249	244	244	242	262	278	288			
Norfolk & Western	281	283	288	284	290	297	304	311	313	322
New York, Chicago & St. Louis	237	233	233							
Southern Railway	219	219	224	225	228	231	230	233	238	239
Illinois Central	260	271	261	264	278	280	268	283	293	270
Southern Pacific	474	501	492	498	501	525	548	528	510	515
Union Pacific	579	582	585	588	599	615	620	641	653	640

Source: National Rail System, ICC and AAR; selected railroads; Moody's Transportation Manual.

TABLE A-27.—AVERAGE LENGTH OF TRAINS, IN NUMBER OF CARS, CLASS I RAILROAOS AND REGIONAL DISTRICTS, 1960-70

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroads	69.6	70.4	70.5	70.3	69.7	69.6	69.3	70.5	70.1	70.0	70.1
Eastern district	71.2	71.9	72.3	72.2	71.2	72.1	72.6	74.9	74.3	73.8	72.7
Southern district	69.8	70.5	70.8	69.4	69.6	70.9	72.1	72.5	70.3	71.5	68.6
Western district	68.4	69.3	69.3	69.3	68.7	67.6	66.5	67.2	67.4	67.4	69.0

Source: ICC and AAR.

TABLE A-28.—AVERAGE FREIGHT TRAIN LOAD[1], CLASS I RAILROADS, REGIONAL DISTRICTS, AND SELECTED RAILROADS, 1960-70

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I Railroads	1,453	1,495	1,544	1,590	1,618	1,685	1,715	1,740	1,768	1,804	1,820
Eastern District	1,586	1,613	1,669	1,722	1,747	1,821	1,878	1,939	1,972	1,994	1,981
Penn Central									1,922	1,825	1,705
Pennsylvania	1,540	1,573	1,605	1,662	1,683	1,783	1,864	1,936			
New York Central	1,405	1,437	1,523	1,594	1,591	1,712	1,858	1,906			
Norfolk & Western	2,824	3,058	3,115	3,254	2,095	2,201	2,322	2,398	2,449	2,512	2,545
New York, Chicago & St. Louis	1,424	1,426	1,418	1,447							
Southern District	1,497	1,545	1,608	1,640	1,690	1,812	1,873	1,905	1,874	1,951	1,881
Southern Railway	(2)	1,571	1,630	1,632	1,684	1,828	1,843	1,942	1,977	1,917	1,725
Illinois Central	(2)	1,633	1,748	1,778	1,827	1,885	1,904	1,799	1,794	1,954	1,833
Western District	1,350	1,400	1,440	1,486	1,509	1,555	1,567	1,566	1,614	1,649	1,703
Southern Pacific	(2)	1,436	1,459	1,474	1,495	1,526	1,538	1,544	1,716	1,741	1,911
Union Pacific	(2)	1,418	1,449	1,508	1,541	1,570	1,552	1,585	1,585	1,718	1,343

[1] Net ton miles per train mile.
[2] Not available.

Sources: Class I, Regional Districts—ICC and AAR; Selected Railroads—Moody's Transportation Manual.

TABLE A-29.—GROSS TON-MILES PER FREIGHT TRAIN HOUR, CLASS I RAILROADS AND SELECTED RAILROADS, 1960-70

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
All class I railroads	63,096	65,598	67,504	68,927	69,724	71,222	73,183	75,103	76,222	76,448	78,111
Penn Central									72,281	68,883	72,277
Pennsylvania	56,134	58,858	62,413	63,790	64,196	66,176	69,441	71,550			
New York Central	59,458	60,056	61,647	62,716	65,959	69,761	73,795	76,557			
Norfolk & Western	89,564	94,731	97,688	99,416	82,131	82,772	82,002	91,133	92,690	93,831	92,795
New York, Chicago & St. Louis	59,013	59,622	56,536	56,104							
Southern Railway	(1)	59,490	61,220	59,604	60,325	57,453	63,794	66,859	65,230	67,169	69,002
Illinois Central	(1)	63,413	66,092	65,694	65,812	67,040	71,347	65,199	62,807	63,074	52,279
Southern Pacific	(1)	79,241	80,457	81,151	83,064	81,982	84,646	87,603	92,097	93,257	109,098
Union Pacific	(1)	93,512	94,814	98,633	104,226	107,116	111,831	116,316	119,369	121,859	128,502

[1] Not available.

Source: Moody's Transportation Manual.

TABLE A-30.—LOADED CAR MILES AS PERCENTAGE OF TOTAL CAR MILES, SELECTED RAILROADS, 1961-70

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Penn Central								58.7	58.5	64.1
Pennsylvania	60.4	61.8	61.8	61.3	61.6	61.9	60.6			
New York Central	55.7	56.9	57.6	57.4	57.6	58.0	57.0			
Norfolk & Western	53.9	53.9	53.7	54.3	56.2	55.2	53.8	54.7	54.9	53.0
New York, Chicago & St. Louis	62.0	62.2	61.4							
Illinois Central	60.0	59.5	58.9	58.5	60.2	59.2	56.6	56.5	58.3	55.3
Southern Pacific	63.8	64.2	64.1	63.8	64.2	64.4	62.4	62.2	62.9	61.2
Union Pacific	64.9	64.4	64.1	63.4	63.8	62.0	60.6	60.6	60.1	57.9

Source: Moody's Transportation Manual.

TABLE A-31.—AVERAGE FREIGHT CAR CAPACITY, CLASS I RAILROADS, 1960-70

Year	Tons	Year	Tons
1960	55.4	1966	61.4
1961	55.7	1967	63.4
1962	56.3	1968	64.3
1963	56.8	1969	65.8
1964	58.3	1970	67.1
1965	59.7		

Source: ICC and AAR.

TABLE A-32.—UNSERVICEABLE EQUIPMENT, CLASS I RAILROADS, 1960-69

Year	Unserviceable freight cars as percent of total fleet	Unserviceable locomotives as percent of total fleet	Year	Unserviceable freight cars as percent of total fleet	Unserviceable locomotives as percent of total fleet
1960	7.8	6.6	1965	5.1	6.0
1961	8.4	6.9	1966	4.4	6.2
1962	7.6	7.1	1967	4.6	6.7
1963	7.0	6.9	1968	4.8	5.9
1964	5.4	6.6	1969	4.9	6.3

Source: Moody's Transportation Manual.

TABLE A-33.—AVERAGE FREIGHT TRAIN SPEED, CLASS I RAILROADS, 1960-70

Year	Miles per hour	Year	Miles per hour
1960	19.5	1966	20.3
1961	19.9	1967	20.3
1962	20.0	1968	20.4
1963	20.1	1969	20.1
1964	20.2	1970	20.1
1965	20.1		

Source: ICC and AAR.

TABLE A-34.- TIME AVERAGE LOCOMOTIVE SPENDS IN ROAD TRAINS,[1] CLASS I RAILROADS, 1960-69

(Hours; 1960=100)

Year	Hours per day in road train	Index	Year	Hours per day in road train	Index
1960	7.34	100.0	1965	11.53	157.1
1961	7.38	100.5	1966	11.40	155.3
1962	7.41	100.9	1967	10.80	147.1
1963	7.47	101.8	1968	10.76	146.6
1964	11.34	154.5	1969	10.80	147.1

[1] Daily locomotive mileage times average freight train speed.

Source: ICC and AAR.

TABLE A-35.—PERCENTAGE SHARE OF TOTAL CLASS I RAIL TONNAGE (ORIGINATED AND RECEIVED) FOR SELECTED RAILROADS, 1961-70

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Penn Central[1]	12.6	12.8	12.6	12.5	12.6	12.2	12.1	11.0	11.3	10.8
Norfolk & Western[2]	5.3	5.3	5.4	(3)	6.6	6.4	6.3	6.4	6.4	6.3
Southern Railway	3.1	3.2	3.3	3.3	3.5	3.5	3.7	4.0	4.1	4.1
Illinois Central	3.0	3.1	3.2	3.0	3.0	3.0	3.1	3.1	3.1	3.3
Southern Pacific	4.5	4.4	4.4	4.3	4.6	4.6	4.4	4.7	4.9	4.8
Union Pacific	2.6	2.5	2.5	2.5	2.5	2.6	2.6	2.6	2.7	2.8

[1] 1961-67 pro forma.
[2] 1961-64 pro forma estimate.
[3] Not available.

Source: Moody's Transportation Manual.

TABLE A-36.—PERCENTAGE OF ORIGINATED TONNAGE TERMINATED, SELECTED RAILROADS, 1961-70

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Penn Central [1]	52.3	52.1	51.1	52.6	53.2	52.9	51.7	62.0	63.0	62.0
Norfolk & Western [2]	41.2	41.6	43.0	(3)	45.1	47.2	50.7	51.9	51.4	54.3
Southern Railway	57.1	57.5	57.3	58.6	58.1	58.8	61.1	59.7	59.4	57.8
Illinois Central	57.7	58.2	58.0	56.7	53.4	55.4	55.9	59.1	56.5	56.7
Southern Pacific	62.8	62.3	61.0	60.8	60.7	62.4	60.0	61.0	63.4	63.7
Union Pacific	62.7	62.8	63.1	63.3	62.6	60.3	60.6	59.9	58.8	57.2

[1] 1961-67 pro forma.
[2] 1961-64 pro forma estimate.
[3] Not available.

Source: Moody's Transportation Manual.

TABLE A-37.—PERCENTAGE OF RECEIVED TONNAGE TERMINATED, SELECTED RAILROADS, 1961-70

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Penn Central [1]	64.1	64.6	65.9	68.2	68.9	71.2	72.3	(2)	74.1	75.1
Norfolk & Western [3]	58.4	59.1	44.5	(2)	60.0	59.5	60.5	62.0	63.5	63.7
Southern Railway	71.0	70.6	70.2	70.0	69.2	69.2	67.3	62.3	61.9	63.8
Illinois Central	62.1	65.2	65.3	66.8	63.2	67.0	69.6	69.9	71.0	74.4
Southern Pacific	70.1	75.5	73.4	74.9	76.4	79.8	80.2	80.2	80.3	81.1
Union Pacific	44.4	46.7	46.8	46.1	45.9	47.4	49.1	47.9	49.2	49.2

[1] 1961-67 pro forma.
[2] Not available.
[3] 1961-64 pro forma estimate.

Source: Moody's Transportation Manual.

TABLE A-38.—PERCENTAGE OF TOTAL FREIGHT TERMINATED, SELECTED RAILROADS, 1961 AND 1970

	1961	1970
Penn Central [1]	59	69
Norfolk & Western [1]	46	57
Southern Railway	64	61
Illinois Central	60	61
Southern Pacific	66	62
Union Pacific	55	59

[1] 1961 pro forma.

Source: Moody's Transportation Manual.

TABLE A-39.—TRAILER ON FLAT CAR CARLOADINGS AS A PERCENT OF TOTAL CARLOADINGS, CLASS I RAILROADS AND REGIONAL DISTRICTS, 1960-70

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Class I railroads	1.8	2.1	2.5	2.8	3.1	3.5	3.9	4.3	4.7	4.8	4.7
Eastern district	2.2	2.7	3.2	3.4	3.8	4.2	4.6	4.9	5.4	5.2	5.0
Southern district	.4	.7	1.2	1.8	2.1	2.8	3.3	3.5	3.8	4.2	4.4
Western district	2.1	2.1	2.3	2.6	2.8	3.3	3.6	4.1	4.6	4.6	4.4

Source: ICC and AAR.

APPENDIX B

EXHIBIT 1

Gross national product or expenditure in 1958 dollars, 1929–71

[Billions of 1958 dollars]

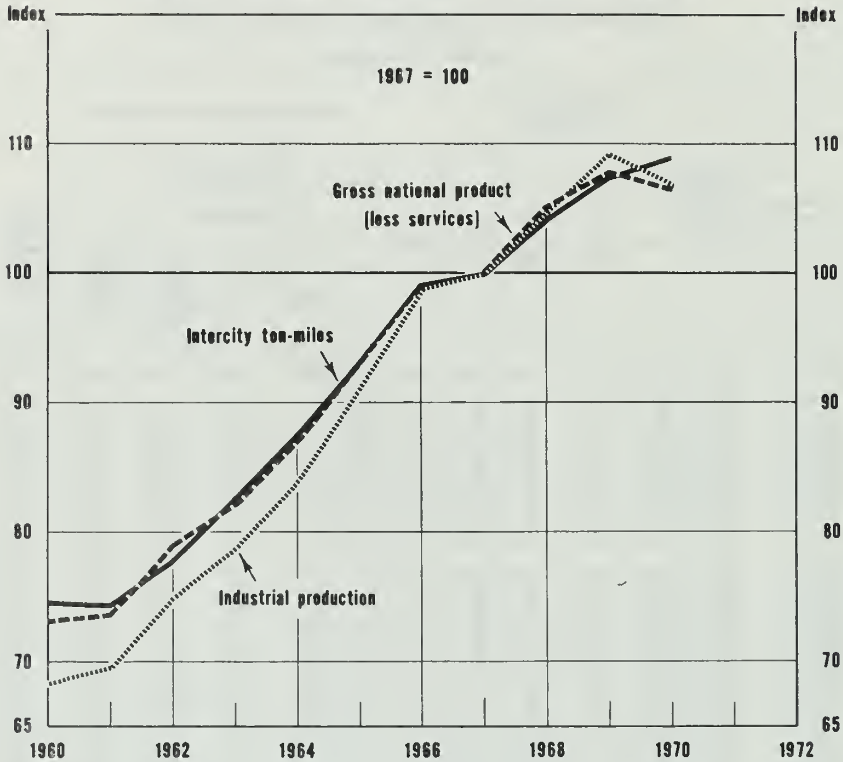
Year or quarter	Total gross national product	Personal consumption expenditures				Gross private domestic investment						
							Fixed investment					Change in business inventories
								Nonresidential			Residential structures	
		Total	Durable goods	Nondurable goods	Services	Total	Total	Total	Structures	Producers' durable equipment		
1929	203.6	139.6	16.3	69.3	54.0	40.4	36.9	26.5	13.9	12.6	10.4	3.5
1930	183.5	130.4	12.9	65.9	51.5	27.4	28.0	21.7	11.8	9.9	6.3	−.6
1931	169.3	126.1	11.2	65.6	49.4	16.8	19.2	14.1	7.5	6.6	5.1	−2.4
1932	144.2	114.8	8.4	60.4	45.9	4.7	10.9	8.2	4.4	3.8	2.7	−6.2
1933	141.5	112.8	8.3	58.6	46.0	5.3	9.7	7.6	3.3	4.3	2.1	−4.3
1934	154.3	118.1	9.4	62.5	46.1	9.4	12.1	9.2	3.6	5.6	2.9	−2.7
1935	169.5	125.5	11.7	65.9	47.9	18.0	15.6	11.5	4.0	7.5	4.0	2.4
1936	193.0	138.4	14.5	73.4	50.5	24.0	20.9	15.8	5.4	10.3	5.1	3.1
1937	203.2	143.1	15.1	76.0	52.0	29.9	24.5	18.8	7.1	11.8	5.6	5.5
1938	192.9	140.2	12.2	77.1	50.9	17.0	19.4	13.7	5.6	8.1	5.7	−2.4
1939	209.4	148.2	14.5	81.2	52.5	24.7	23.5	15.3	5.9	9.4	8.2	1.2
1940	227.2	155.7	16.7	84.6	54.4	33.0	28.1	18.9	6.8	12.1	9.2	4.9
1941	263.7	165.4	19.1	89.9	56.3	41.6	32.0	22.2	8.1	14.2	9.8	9.6
1942	297.8	161.4	11.7	91.3	58.5	21.4	17.3	12.5	4.6	7.9	4.9	4.0
1943	337.1	165.8	10.2	93.7	61.8	12.7	12.9	10.0	2.9	7.2	2.9	−.2
1944	361.3	171.4	9.4	97.3	64.7	14.0	15.9	13.4	3.8	9.6	2.5	−1.9
1945	355.2	183.0	10.6	104.7	67.7	19.6	22.6	19.8	5.7	14.1	2.8	−2.9
1946	312.6	203.5	20.5	110.8	72.1	52.3	42.3	30.2	12.5	17.7	12.1	10.0
1947	309.9	206.3	24.7	108.3	73.4	51.5	51.7	36.2	11.6	24.6	15.4	−.2
1948	323.7	210.8	26.3	108.7	75.8	60.4	55.9	38.0	12.3	25.7	17.9	4.6
1949	324.1	216.5	28.4	110.5	77.6	48.0	51.9	34.5	11.9	22.6	17.4	−3.9
1950	355.3	230.5	34.7	114.0	81.8	69.3	61.0	37.5	12.7	24.8	23.5	8.3
1951	383.4	232.8	31.5	116.5	84.8	70.0	59.0	39.6	14.1	25.5	19.5	10.9
1952	395.1	239.4	30.8	120.8	87.8	60.5	57.2	38.3	13.7	24.6	18.9	3.3
1953	412.8	250.8	35.3	124.4	91.1	61.2	60.2	40.7	14.9	25.8	19.6	.9
1954	407.0	255.7	35.4	125.5	94.8	59.4	61.4	39.6	15.2	24.5	21.7	−2.0
1955	438.0	274.2	43.2	131.7	99.3	75.4	69.0	43.9	16.2	27.7	25.1	6.4
1956	446.1	281.4	41.0	136.2	104.1	74.3	69.5	47.3	18.5	28.8	22.2	4.8
1957	452.5	288.2	41.5	138.7	108.0	68.8	67.6	47.4	18.2	29.1	20.2	1.2
1958	447.3	290.1	37.9	140.2	112.0	60.9	62.4	41.6	16.6	25.0	20.8	−1.5
1959	475.9	307.3	43.7	146.8	116.8	73.6	68.8	44.1	16.2	27.9	24.7	4.8
1960	487.7	316.1	44.9	149.6	121.6	72.4	68.9	47.1	17.4	29.6	21.9	3.5
1961	497.2	322.5	43.9	153.0	125.6	69.0	67.0	45.5	17.4	28.1	21.6	2.0
1962	529.8	338.4	49.2	158.2	131.1	79.4	73.4	49.7	17.9	31.7	23.8	6.0
1963	551.0	353.3	53.7	162.2	137.4	82.5	76.7	51.9	17.9	34.0	24.8	5.8
1964	581.1	373.7	59.0	170.3	144.4	87.8	81.9	57.8	19.1	38.7	24.2	5.8
1965	617.8	397.7	66.6	178.6	152.5	99.2	90.1	66.3	22.3	44.0	23.8	9.0
1966	658.1	418.1	71.7	187.0	159.4	109.3	95.4	74.1	24.0	50.1	21.3	13.9
1967	675.2	430.1	72.9	190.2	167.0	101.2	93.5	73.2	22.6	50.6	20.4	7.7
1968	706.6	452.7	81.3	197.1	174.4	105.2	98.8	75.6	23.4	52.2	23.2	6.4
1969	724.7	469.3	84.8	202.7	181.8	109.6	103.2	80.1	24.5	55.7	23.1	6.4
1970	720.0	475.9	81.4	207.3	187.2	102.2	99.9	78.6	24.2	54.4	21.3	2.3
1971 p	739.5	491.9	89.3	211.6	191.0	107.9	105.9	78.8	22.4	56.5	27.0	2.0
	Seasonally adjusted annual rates											
1970: I	719.8	474.4	82.3	205.7	186.4	101.0	100.7	79.3	24.6	54.7	21.4	0.3
II	721.1	477.1	83.8	206.5	186.8	102.7	100.7	79.4	24.4	55.0	21.3	2.0
III	723.3	477.9	82.8	207.3	187.9	104.0	100.1	80.1	24.2	55.9	20.0	3.9
IV	715.9	474.2	76.6	209.7	187.9	101.2	98.1	75.5	23.5	52.0	22.6	3.1
1971: I	729.7	484.8	85.9	210.0	188.9	104.3	101.8	77.7	22.6	55.0	24.1	2.5
II	735.8	489.4	87.8	211.5	190.1	110.0	105.9	79.1	22.9	56.2	26.7	4.1
III	740.7	494.3	91.2	211.6	191.4	106.7	107.2	78.9	22.1	56.8	28.3	−.5
IV p	751.7	499.2	92.4	213.4	193.4	110.4	108.6	79.6	21.8	57.8	28.9	1.9

See footnotes at end of table.

Source: Council of Economic Advisers, *Economic Report to the President, 1972*, p. 196.

Exhibit 2

INDEXES OF INTERCITY TON-MILES, INDUSTRIAL PRODUCTION, AND GROSS NATIONAL PRODUCT (LESS SERVICES), 1960-1970



Sources: Federal Reserve Board, Office of Business Economics, and Interstate Commerce Commission.
Source: Interstate Commerce Commission, *85th Annual Report to Congress, 1971*, p. 139.

September-October 1971

Exhibit 3

Revenues of carriers and national income,[1] 1939, 1959-1970

Year	Railroads - class I & II (a)	Class I, II and III: Motor carriers of property (b)	Class I, II and III: Motor carriers of passengers (c)	Domestic scheduled air carrier operations (d)	Pipelines under I. C. C. jurisdiction (e)	National income[2] (f)
	millions	*millions*	*millions*	*millions*	*millions*	*billions*
1939	$ 4,140.3	$ 792.2	$ 169.1	$ 55.9[3]	$ 212.5	$ 72.6
1959	10,206.6	7,145.0	630.8	1,940.8[3]	765.2	400.0
1960	9,898.9	7,213.9	667.0	2,113.3[3]	770.4	414.5
1961	9,540.3	7,462.7	689.5	2,245.5	786.7	427.3
1962	9,791.8	8,131.1	728.9	2,497.8	810.6	457.7
1963	9,921.5	8,548.3	758.9	2,722.5	840.3	481.9
1964	10,251.7	9,154.8	802.1	3,094.6	865.1	518.1
1965	10,702.3	10,068.2	885.1	3,608.5	903.8	564.3
1966	11,163.4	10,861.8	901.1	4,070.3	941.1	620.6
1967	10,848.7	11,308.4	945.3	4,886.6	994.5	653.6
1968	11,356.7	12,715.0	990.6	5,606.1	1,023.0	r 711.1
1969	11,951.0	13,944.0	1,007.0	6,857.0	1,103.3	r 763.7
1970p	12,500.0	14,400.0	1,037.0	7,130.7	1,188.0	795.9
			Index 1967 = 100			
1939	38.2	7.0	17.9	1.1	21.4	11.1
1959	94.1	63.2	66.7	39.7	76.9	61.2
1960	91.2	63.8	70.6	43.2	77.5	63.4
1961	87.9	66.0	72.9	46.0	79.1	65.4
1962	90.3	71.9	77.1	51.1	81.5	70.0
1963	91.5	75.6	80.3	55.7	84.5	73.7
1964	94.5	81.0	84.9	63.3	87.0	79.3
1965	98.7	89.0	93.6	73.8	90.9	86.3
1966	102.9	96.1	95.3	83.3	94.6	95.0
1967	100.0	100.0	100.0	100.0	100.0	100.0
1968	104.7	112.4	104.8	114.7	102.9	108.8
1969	110.2	123.3	106.5	140.3	110.9	116.8
1970	115.2	127.3	109.7	145.9	119.5	121.8
			Ratio to national income (100)			
1939	5.7	1.1	0.2	0.1	0.2	100
1959	2.6	1.8	0.2	0.5	0.2	100
1960	2.4	1.7	0.2	0.5	0.2	100
1961	2.2	1.7	0.2	0.5	0.2	100
1962	2.1	1.8	0.2	0.5	0.2	100
1963	2.1	1.8	0.2	0.6	0.2	100
1964	2.0	1.8	0.2	0.6	0.2	100
1965	1.9	1.8	0.2	0.6	0.2	100
1966	1.8	1.7	0.1	0.7	0.2	100
1967	1.7	1.7	0.1	0.7	0.2	100
1968	1.6	1.8	0.1	0.8	0.1	100
1969	1.6	1.8	0.1	0.9	0.1	100
1970	1.6	1.8	0.1	0.9	0.1	100

r Revised. p Preliminary.

[1]Current dollars.

[2]Includes all revisions through those reported in *The Biennial Supplement to Survey of Current Business*, 1967 and *Survey of Current Business*, August 1971.

[3]Does not include Alaska and Hawaii.

Source: (a), (b), (c), and (e), Interstate Commerce Commission data; (d) Federal Aviation Agency, *Statistical Handbook of Aviation;* and Department of Commerce, *Survey of Current Business*, September 1971.

Source: Interstate Commerce Commission, *Transport Economics*, Sept.-Oct., 1971, p. 9.

EXHIBIT 4

COMPARISON OF INDICES DEPICTING NATIONAL AND REGIONAL GROWTH PATTERNS WITH RAILROAD FREIGHT REVENUES GENERATED BY THE PENNSYLVANIA AND NEW YORK CENTRAL RAILROADS

	Federal Reserve Bank industrial production	Federal Reserve Bank of Boston industrial production	GNP construct 1958 dollars	Pennsylvania revenues	New York Central revenues	New Haven
1954	85.8	91	91	90.9	98.0	99.8
1955	96.6	98	98	104.0	109.1	198.1
1956	99.9	102	100	111.0	112.2	110.9
1957	100.7	100	101	110.8	107.7	110.7
1958	93.7	93	100	91.9	93.2	95.2
1959	105.6	107	106	97.4	99.1	94.1
1960	108.7	109	109	92.3	97.0	85.9
1961	109.7	112	111	88.9	87.9	81.3
1962	118.3	118	118	94.0	90.7	81.4
1963	124.3	119	123	93.0	91.0	76.8
1964	132.3	124	130	97.9	94.9	77.1
1965	143.4	134	138	101.8	99.4	77.6
1966	156.3	146	147	104.1	101.5	80.2
1967	158.1	147	151	101.7	98.2	75.1
1968	165.5	147	158	103.2		77.2
1969	172.8	147	163	110.8		

Source: Columns 1 and 5—Selected issues of the Federal Reserve Bulletin. Column 2—Production Indices Supplied by the Federa Reserve Bank of Boston. Columns 6, 7, and 8—pt. 1, Transport Statistics in the United States, ICC.

EXHIBIT 5

TREND IN TONNAGE ORIGINATED—MANUFACTURES AND MISCELLANEOUS[1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	400,857	219,561	30,870	49,297	4,436
1952	378,927	198,042	27,992	42,776	4,368
1953	389,633	210,043	28,705	44,488	4,683
1954	341,716	172,397	24,797	34,767	3,751
1955	392,592	207,068	29,537	44,190	4,085
1956	400,197	209,678	28,833	44,571	4,121
1957	374,332	193,711	26,788	40,140	3,647
1958	322,618	149,265	21,960	29,514	3,058
1959	354,604	167,577	24,151	34,675	3,420
1960	344,284	161,914	23,136	32,699	3,100
1961	332,655	149,774	21,534	30,927	2,881
1962	349,060	159,821	23,948	33,081	2,721
1963	368,020	169,564	25,424	35,644	2,654
1964	662,328	259,601	(2)	(2)	(2)
1965	685,987	272,783	64,335	97,468	4,353
1966	703,999	274,570	62,828	99,964	4,524
1967	697,630	262,345	59,217	93,440	3,670
1968	724,942	273,183	146,294		
1969	743,098	274,707	153,314		
1970	716,103	256,797	142,537		

EXHIBIT 6

INDEX OF TONNAGE ORIGINATED—MANUFACTURES AND MISCELLANEOUS[1]

[1951–63 index (1957–59); 1965–70 index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	114.4	129.0	127.0	141.8	131.4
1952	108.1	116.4	115.2	123.0	130.0
1953	111.2	123.4	118.1	127.9	138.8
1954	97.5	101.3	102.0	100.0	111.1
1955	112.0	121.7	121.6	127.1	121.0
1956	114.2	123.2	118.7	128.2	122.1
1957	106.8	113.8	110.2	115.4	108.1
1958	92.0	87.7	90.4	84.9	90.6
1959	101.2	98.5	99.4	99.7	101.3
1960	98.2	95.1	95.2	94.0	91.9
1961	94.9	88.0	88.6	88.9	85.4
1962	99.6	93.9	98.6	95.1	80.6
1963	105.0	99.6	104.6	102.5	78.6
1964	94.9	99.0			
1965	98.3	104.0	108.6	104.3	118.6
1966	100.9	104.7	106.1	107.0	123.3
1967	100.0	100.0	100.0	100.0	100.0
1968	103.9	104.1	93.6		
1969	106.5	104.7	98.1		
1970	102.6	97.9	91.2		

[1] There are 2 separate trends (1951–63 and 1965–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region included in Eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: 1951–63 manufactures and miscellaneous; 1965–70 includes all categories of traffic.

EXHIBIT 7

TRENDS IN TONNAGE TERMINATED—MANUFACTURES AND MISCELLANEOUS [1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Penn-sylvania	New Haven
1951	406,388	213,661	30,541	48,610	9,405
1952	385,241	193,977	27,085	43,281	9,030
1953	395,454	203,792	28,665	44,387	9,723
1954	348,659	169,759	24,603	33,739	8,598
1955	400,364	205,098	29,609	43,345	9,611
1956	407,760	207,715	28,592	44,034	9,896
1957	380,598	190,924	26,084	39,464	9,346
1958	328,214	149,372	21,579	30,078	7,908
1959	360,427	167,550	25,019	34,965	7,942
1960	350,686	161,585	24,271	32,635	7,310
1961	339,608	150,245	22,193	31,176	7,179
1962	357,420	160,434	25,011	33,883	7,343
1963	375.989	169,180	25,884	36,260	7,376
1964	676,107	272,478	(2)	(2)	(2)
1965	700,122	287,725	83,174	111,833	14,478
1966	715,817	289,987	83,584	116,346	14,704
1967	709,297	277,636	83,898	109,449	13,467
1968	741,106	293,048	190,916		
1969	759,647	296,970	205,373		
1970	732,252	281,123	192,025		

EXHIBIT 8

INDEX OF TONNAGE TERMINATED—MANUFACTURES AND MISCELLANEOUS [1]

[1951-63, Index (1957-59); 1964-70, Index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Penn-sylvania	New Haven
1951	114.0	126.3	126.1	139.5	112.0
1952	108.1	114.6	111.8	124.2	107.5
1953	111.0	120.4	118.3	127.4	115.8
1954	97.8	100.3	101.6	96.9	102.4
1955	112.3	121.2	122.2	124.4	114.4
1956	114.4	122.7	118.0	126.4	117.8
1957	106.8	112.8	107.7	113.3	111.3
1958	92.1	88.2	89.1	86.3	94.2
1959	101.1	99.0	103.3	100.4	94.6
1960	98.4	95.4	100.2	93.7	87.0
1961	95.3	88.8	91.6	89.5	85.5
1962	100.3	94.8	103.2	97.3	87.4
1963	105.5	99.9	106.8	104.1	87.8
1964	95.3	98.1			
1965	98.7	103.6	99.1	102.1	107.5
1966	100.9	104.4	99.6	106.3	109.2
1967	100.0	100.0	100.0	100.0	100.0
1968	104.5	105.6	92.3		
1969	107.1	107.0	99.3		
1970	103.2	101.3	92.8		

[1] There are 2 separate trends (1951-63 and 1965-70) since the classification was revised in 1965. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: 1951-63 manufactures and miscellaneous; 1965-70 includes all categories of traffic (products of forests, mines, etc.).

EXHIBIT 9

TRENDS IN REVENUES—MANUFACTURES AND MISCELLANEOUS [1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Pennsyl-vania	New Haven
1951	4,199,573	1,803,448	317,458	415,137	56,560
1952	4,273,019	1,777,419	308,027	406,886	57,506
1953	4,529,620	1,899,843	330,939	426,526	61,063
1954	3,808,064	1,551,575	273,708	327,579	50,914
1955	4,219,745	1,766,233	311,493	379,156	55,925
1956	4,353,051	1,827,509	308,923	395,029	59,326
1957	4,383,839	1,840,016	305,718	398,261	59,385
1958	3,888,888	1,519,113	256,747	325,046	50,401
1959	4,160,507	1,651,369	284,361	367,090	50,914
1960	4,016,056	1,588,396	279,468	343,107	46,573
1961	3,928,368	1,491,298	253,623	333,287	44,542
1962	4,171,339	1,600,621	275,162	362,115	45,051
1963	4,295,581	1,644,660	282,485	372,397	43,630
1964	5,779,327	2,185,134	(2)	(2)	(2)
1964	6,144,301	1,917,889	554,008	735,361	67,713
1966	6,457,856	1,300,825	567,987	748,734	70,280
1967	6,435,454	940,448	552,969	723,394	65,709
1968	7,090,419	854,921	1,323,388		
1969	7,640,910	585,955	1,447,817		
1970	7,739,328	321,266	1,478,135		

EXHIBIT 10

INDEX OF REVENUES—MANUFACTURES AND MISCELLANEOUS [1]

[1951-63 Index (1957-69); 1965-70 Index (1969)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsyl-vania	New Haven
1951	101.3	108.0	112.5	114.2	105.6
1952	103.1	106.4	109.1	111.9	107.4
1953	109.3	113.8	117.2	117.3	114.0
1954	91.9	92.9	97.0	90.1	95.0
1955	101.8	105.8	110.4	104.3	104.4
1956	105.0	109.4	109.4	108.7	110.8
1957	105.8	110.2	108.3	109.6	110.9
1958	93.8	91.0	91.0	89.4	94.1
1959	100.4	98.9	100.7	101.0	95.0
1960	96.9	95.1	99.0	94.4	86.9
1961	94.8	89.3	89.8	91.7	83.2
1962	100.6	95.8	97.5	99.6	84.1
1963	103.6	98.5	100.1	102.5	81.4
1964	89.8	232.4			
1964	95.5	203.9	100.2	101.7	103.0
1966	100.3	138.3	102.7	103.5	107.0
1967	100.0	100.0	100.0	100.0	100.0
1968	110.2	90.9	98.6		
1969	118.7	62.3	107.9		
1970	120.3	34.2	110.1		

[1] There are 2 separate trends (1951-63 and 1965-70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: 1951-63 manufactures and miscellaneous; 1965-70 includes all categories of traffic.

EXHIBIT 11

TREND IN TONNAGE ORIGINATED—PRODUCTS OF MINES[1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	819,373	434,330	29,001	59,301	1,088
1952	752,699	389,012	27,970	52,295	1,115
1953	754,293	375,244	28,152	51,885	1,222
1954	650,072	320,431	25,919	42,736	926
1955	761,993	378,322	29,879	51,034	1,137
1956	796,480	406,738	34,596	54,710	1,425
1957	769,675	392,712	31,075	53,852	1,974
1958	628,911	309,059	25,300	43,920	1,199
1959	632,870	313,720	26,958	45,134	1,045
1960	649,227	309,101	28,754	43,673	987
1961	615,646	294,350	27,210	38,777	960
1962	634,747	307,688	28,207	43,312	1,219
1963	662,402	325,202	29,535	44,140	1,527
1964	475,167	280,448	(2)	(2)	(2)
1965	482,678	280,660	21,789	40,131	281
1966	506,487	285,028	20,427	42,943	338
1967	494,682	281,602	18,907	40,646	216
1968	491,863	278,160	53,364		
1969	510,692	277,240	56,915		
1970	532,190	281,218	54,427		

EXHIBIT 12

INDEX OF TONNAGE ORIGINATED—PRODUCTS OF MINES[1]

[1951–63 Index (1957–59); 1964–70 Index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	121.0	128.3	104.5	124.5	77.4
1952	111.2	114.9	100.7	109.8	79.3
1953	111.4	110.9	101.4	108.9	86.9
1954	96.0	94.7	93.3	89.7	65.9
1955	112.5	111.8	107.6	107.1	80.9
1956	117.6	120.2	124.5	114.9	101.4
1957	113.7	116.0	111.9	113.1	140.4
1958	92.9	91.3	91.1	92.2	85.3
1959	93.5	92.7	97.1	94.8	74.3
1960	95.9	91.3	103.5	91.7	70.2
1961	90.9	87.0	98.0	81.4	68.3
1962	93.7	90.9	101.5	90.9	86.7
1963	97.8	96.1	106.3	92.7	108.6
1964	96.1	99.6			
1965	97.6	99.7	115.2	98.7	130.1
1966	102.4	101.2	108.0	105.7	156.5
1967	100.0	100.0	100.0	100.0	100.0
1968	99.4	98.8	89.3		
1969	103.2	98.5	95.2		
1970	107.6	99.9	91.1		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in Eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "Products of Mines;" years 1965–70 "Nonmetallic Minerals, Coal and Petroleum and Petroleum Products," Freight Commodity Statistics, ICC.

EXHIBIT 13

TREND IN TONNAGE TERMINATED—PRODUCTS OF MINES[1]

[In thousands]

	Total Class I Railroads	Eastern District Railroads	New York Central	Pennsylvania	New Haven
1951	698,098	437,499	57,120	80,909	5,589
1952	649,235	390,156	53,685	71,909	4,913
1953	641,302	388,613	53,308	73,810	4,024
1954	562,203	316,979	42,523	57,253	3,855
1955	652,415	386,854	47,497	70,247	4,047
1956	701,876	413,449	52,828	70,988	4,658
1957	670,646	401,862	46,436	68,777	5,224
1958	562,480	307,700	37,758	49,550	4,444
1959	571,063	305,446	41,292	52,507	4,246
1960	581,204	315,551	41,449	52,356	3,967
1961	554,206	288,102	36,631	47,720	4,094
1962	575,336	302,190	38,054	49,626	4,060
1963	596,747	312,207	40,161	52,220	3,993
1964	404,942	259,988	(2)	(2)	(2)
1965	409,787	265,631	35,941	45,613	2,327
1966	433,926	272,547	36,063	48,200	2,360
1967	434,797	275,581	37,553	46,038	1,821
1968	421,856	262,526	80,556		
1969	445,211	276,278	82,412		
1970	468,535	275,477	77,848		

EXHIBIT 14

INDEX OF TONNAGE TERMINATED—PRODUCT OF MINES[1]

[1951–63 Index (1957–59); 1964–70 Index (1967)]

	Total Class I Railroads	Eastern District Railroads	New York Central	Pennsylvania	New Haven
1951	116.1	129.3	136.6	142.1	120.5
1952	108.0	115.3	128.3	126.3	105.9
1953	106.6	114.9	127.4	129.6	86.8
1954	93.5	93.7	101.7	100.5	83.1
1955	108.5	114.3	113.6	123.4	87.3
1956	116.7	122.2	126.3	124.7	100.4
1957	111.5	118.8	111.0	120.8	112.6
1958	93.5	90.9	90.3	87.0	95.8
1959	95.0	90.3	98.7	92.2	91.5
1960	96.6	93.3	99.1	91.9	85.5
1961	92.2	85.2	87.6	83.8	88.3
1962	95.7	89.3	91.0	87.1	87.5
1963	99.2	92.3	96.0	91.7	86.1
1964	93.1	94.3			
1965	94.2	96.4	95.7	99.1	127.8
1966	99.8	98.9	96.0	104.7	129.6
1967	100.0	100.0	100.0	100.0	100.0
1968	97.0	95.3	94.3		
1969	102.4	100.3	96.5		
1970	107.8	100.0	91.1		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region included in Eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "Products of Mines;" Years 1965–70 "Nonmetallic Minerals, Coal and Petroleum and Petroleum Products," Freight Commodity Statistics, ICC.

EXHIBIT 15

TREND IN REVENUES—PROOUCT OF MINES[1]

[In thousands]

	Total Class I Railroads	Eastern Oistrict Railroad	New York Central	Pennsylvania	New Haven
1951	2,236,103	1,413,372	----------	249,202	12,814
1952	2,184,694	1,343,945	164,991	237,807	12,086
1953	2,158,693	1,312,086	166,253	240,230	10,472
1954	1,830,297	1,081,246	136,279	187,618	9,544
1955	2,121,426	1,297,971	150,609	222,571	9,848
1956	2,358,261	1,470,676	167,381	251,902	11,116
1957	2,390,167	1,503,788	160,268	258,474	12,126
1958	1,985,404	1,199,656	139,157	203,178	10,884
1959	1,977,773	1,185,464	147,155	204,562	10,644
1960	1,969,462	1,179,853	146,902	202,545	9,751
1961	1,862,965	1,101,026	136,022	189,829	9,932
1962	1,915,488	1,142,083	139,084	199,113	10,111
1963	1,966,288	1,167,305	137,452	194,401	9,003
1964	1,404,765	982,102	(2)	(2)	(2)
1965	1,433,227	1,000,140	111,523	160,272	4,062
1966	1,454,023	996,825	106,173	161,658	4,059
1697	1,439,401	991,586	103,796	156,662	3,438
1968	1,435,222	983,828	248,908		
1969	1,519,412	1,019,133	271,480		
1970	1,719,533	1,132,422	289,104		

EXHIBIT 16

INOEX OF REVENUES—PROOUCTS OF MINES[1]

[1951–63 Index (1957–59); 1964–70 Index (1967=100)]

	Total Class I Railroads	Eastern District Railroads	New York Central	Pennsylvania	New Haven
1951	105.6	109.0	----------	112.2	114.2
1952	103.2	103.7	110.8	107.1	107.7
1953	101.9	101.2	111.7	108.2	93.3
1954	86.4	83.4	91.5	84.5	85.1
1955	100.2	100.1	101.2	100.2	87.8
1956	111.4	113.5	112.4	113.4	99.1
1957	112.9	116.0	107.7	116.4	108.1
1958	93.7	92.5	93.5	91.5	97.0
1959	93.4	91.4	98.9	92.1	95.1
1960	92.3	91.0	98.7	91.2	86.9
1961	88.0	84.9	91.4	85.5	88.5
1962	90.4	88.1	93.4	89.7	90.1
1963	92.8	90.0	92.3	87.5	80.3
1964	97.6	99.0	----------	----------	----------
1965	99.6	100.9	----------	----------	----------
1966	101.0	100.5	----------	----------	----------
1967	100.0	100.0	----------	----------	----------
1968	99.7	99.2	94.3		
1969	105.6	102.8	102.9		
1970	119.5	114.2	109.6		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region included in Eastern region.

[2] Individual reports are confidential of 1964.

Source: Years 1951–63 "Products of Mines;" years 1965–70 "Farm Products" less "Livestock and Livestock Products" and "Poultry and Poultry Products." Freight Commodity Statistics, ICC.

EXHIBIT 17

TRENO IN TONNAGE ORIGINATEO—PROOUCTS OF FORESTS[1]

[In thousands]

	Total Class I Railroads	Eastern District Railroads	New York Central	Pennsylvania	New Haven
1951	86,521	7,131	496	640	41
1952	83,480	6,305	433	523	25
1953	82,107	6,005	436	463	30
1954	75,650	5,137	343	412	25
1955	82,585	5,977	388	489	22
1956	87,799	6,517	425	617	21
1957	77,498	5,493	332	559	20
1958	73,287	4,485	286	447	11
1959	80,397	5,058	335	508	17
1960	79,211	5,521	371	534	15
1961	74,924	4,747	279	484	14
1962	78,104	4,971	314	520	14
1963	78,222	5,132	309	606	19
1964	86,071	6,106	(2)	(2)	(2)
1965	88,597	6,957	476	789	64
1966	94,255	7,598	509	826	72
1967	92,638	7,732	474	848	79
1968	98,877	7,453	1,268		
1969	100,631	7,122	1,195		
1970	102,553	6,904	934		

EXHIBIT 18

INOEX OF TONNAGE ORIGINATEO—PROOUCTS OF FORESTS[1]

[1951–63 Index (1957–59); 1964–70 Index (1967)]

	Total Class I Railroads	Eastern District Railroads	New York Central	Pennsylvania	New Haven
1951	112.3	142.3	156.5	127.0	256.3
1952	108.3	125.8	136.6	103.8	156.3
1953	106.5	119.8	137.5	91.9	187.5
1954	98.2	102.5	108.2	81.7	156.3
1955	107.2	119.3	122.4	97.0	137.5
1956	113.9	130.0	134.1	122.4	131.3
1957	100.6	109.6	104.7	110.9	125.0
1958	95.1	89.5	90.2	88.7	68.8
1959	104.3	100.9	105.7	100.8	106.3
1960	102.8	110.2	117.0	106.0	93.8
1961	97.2	94.7	88.0	96.0	87.5
1962	101.4	99.2	99.1	103.2	87.5
1963	101.5	102.4	97.5	120.2	118.8
1964	92.9	79.0	----------	----------	----------
1965	95.6	90.0	100.4	93.0	81.0
1966	101.7	98.3	107.4	97.4	91.1
1967	100.0	100.0	100.0	100.	100.0
1968	106.7	96.4	90.5		
1969	108.6	92.1	85.3		
1970	110.7	89.3	66.7		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in Eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "Products of Forests"; Years 1965–70 "Forest Products" and "Lumber and Wood Products except Furniture." Freight Commodity Statistics, ICC.

EXHIBIT 19

TREND IN TONNAGE TERMINATED—PRODUCTS OF FORESTS[1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	92,541	21,514	3,297	3,382	948
1952	88,482	19,335	2,878	2,977	928
1953	86,414	18,080	2,715	2,754	784
1954	79,955	16,555	2,497	2,516	751
1955	87,696	19,219	2,824	2,871	859
1956	91,943	19,475	2,815	2,952	859
1957	81,332	16,415	2,403	2,641	745
1958	77,384	13,806	2,129	2,159	637
1959	84,938	14,976	2,303	2,389	703
1960	84,055	14,872	2,219	2,281	749
1961	80,009	13,544	1,980	2,164	721
1962	84,091	14,782	2,155	2,279	789
1963	85,169	15,165	2,134	2,492	801
1964	90,538	16,658	(2)	(2)	(2)
1965	91,490	17,702	2,412	2,723	999
1966	97,718	18,312	2,426	2,735	963
1967	96,652	17,992	2,402	2,612	901
1968	104,570	18,475	5,137		
1969	106,587	17,552	5,777		
1970	107,889	16,890	5,206		

EXHIBIT 20

INDEX OF TONNAGE TERMINATED—PRODUCTS OF FORESTS[1]

[1951–63 Index (1957–59); 1964–70 Index (1967=100)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	113.9	142.8	144.7	141.2	136.4
1952	108.9	128.3	126.3	124.2	133.5
1953	106.4	120.0	119.2	114.9	112.8
1954	98.4	109.9	109.6	105.0	108.1
1955	108.0	127.6	124.0	119.8	123.6
1956	113.2	129.3	123.6	123.2	123.6
1957	100.1	109.0	105.5	110.2	107.2
1958	95.3	91.6	93.5	90.1	91.7
1959	104.6	99.4	101.1	99.7	101.2
1960	103.5	98.7	97.4	95.2	107.8
1961	98.5	89.9	86.9	90.3	103.7
1962	103.5	98.1	94.6	95.1	113.5
1963	104.9	100.7	93.7	104.0	115.3
1964	93.7	92.6			
1965	94.7	98.4	100.4	104.2	110.9
1966	101.0	101.8	101.0	104.7	106.9
1967	100.0	100.0	100.0	100.0	100.0
1968	108.2	102.7	86.8		
1969	110.3	97.6	97.7		
1970	111.6	93.9	88.0		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in eastern region so that data are comparable and confidential.

[2] Fundamental reports are confidential for 1964.

Source: Years 1951–63 "Products of Forests"; Years 1964–70 "Forest Products" and "Lumber and Wood Products Except Furniture"; Freight Commodity Statistics, ICC.

EXHIBIT 21

TREND IN REVENUES—PRODUCTS OF FORESTS[1]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	621,702	114,280		23,216	3,847
1952	656,495	110,177	16,376	21,942	3,448
1953	654,745	106,357	15,859	20,558	3,063
1954	627,755	97,582	14,685	18,692	2,771
1955	686,821	110,903	16,899	20,939	3,093
1956	696,718	113,938	17,089	21,149	3,141
1957	654,214	102,789	15,587	19,305	2,878
1958	646,069	90,969	14,263	16,941	2,527
1959	707,958	98,869	15,170	18,384	2,834
1960	650,722	93,734	14,396	16,763	2,903
1961	627,587	86,787	13,192	16,193	2,810
1962	647,233	92,175	13,580	17,375	2,906
1963	660,993	93,705	13,458	17,948	2,885
1964	731,403	106,601	(2)	(2)	(2)
1965	747,699	114,004	16,877	21,290	3,717
1966	760,662	119,007	17,469	21,203	3,634
1967	739,638	112,586	15,975	20,073	3,412
1968	824,885	121,365	39,135		
1969	817,317	120,329	41,612		
1970	845,730	122,264	41,532		

EXHIBIT 22

INDEX OF REVENUES—PRODUCTS OF FORESTS[1]

[1951–63 Index (1957–59); 1964–70 Index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	92.9	117.2		127.5	127.0
1952	98.1	113.0	109.1	120.5	125.6
1953	97.8	109.0	105.7	112.9	111.5
1954	93.8	100.0	97.9	102.6	100.9
1955	102.6	113.7	112.6	115.0	112.6
1956	104.1	116.8	113.9	116.1	114.4
1957	97.7	105.4	103.9	106.0	104.8
1958	96.5	93.3	95.0	93.0	92.0
1959	105.8	101.4	101.1	101.0	103.2
1960	97.2	96.1	95.9	92.1	105.7
1961	93.8	89.0	87.9	88.9	102.3
1962	96.7	94.5	90.5	95.4	105.8
1963	98.7	96.1	89.7	98.6	105.1
1964	98.9	94.7			
1965	101.1	101.3	105.6	106.1	108.9
1966	102.8	105.7	109.4	105.6	106.5
1967	100.0	100.0	100.0	100.0	100.0
1968	111.5	107.8	99.2		
1969	110.5	106.9	105.5		
1970	114.3	108.6	105.3		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region has been included in eastern region so that data ate comparable.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "Products of Forests"; Years 1965–70 "Forest Products" and "Lumber and Wood Products except Furniture" Freight Commodity Statistics, ICC.

EXHIBIT 23

TREND IN TONNAGE ORIGINATED—LCL[1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	10,379	5,365	1,026	1,448	348
1952	9,310	4,572	868	1,201	299
1953	8,255	4,040	769	992	268
1954	6,964	3,155	605	752	206
1955	5,227	3,270	622	797	244
1956	6,485	3,068	575	777	182
1957	5,443	2,607	480	664	152
1958	4,402	1,959	338	482	111
1959	3,923	1,748	282	418	101
1960	3,213	1,361	221	329	79
1961	2,586	968	153	218	51
1962	2,183	643	111	95	35
1963	1,678	351	30	22	23
1964	1,496	162	(2)	(2)	(2)
1965	1,333	98	8	8	4
1966	1,049	83	3	6	3
1967	960	76	2	8	3
1968	867	77	13		
1969	837	74	19		
1970	809	64	17		

EXHIBIT 24

INDEX OF TONNAGE ORIGINATED—LCL[1]

[1951–63 Index (1957–59=100); 1964–70 Index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	226.2	255.0	280.3	277.9	287.6
1952	202.9	217.3	237.2	230.5	183.4
1953	179.9	192.0	210.1	190.4	164.4
1954	151.8	150.0	165.3	144.3	126.4
1955	113.9	155.4	169.9	153.0	149.7
1956	141.3	145.8	157.1	149.1	150.4
1957	118.6	123.9	130.8	127.4	125.6
1958	95.9	93.1	92.3	92.5	68.1
1959	85.5	83.1	77.0	80.2	62.0
1960	70.0	64.7	60.4	63.1	48.5
1961	56.4	46.0	41.8	41.8	31.3
1962	47.6	30.6	30.3	18.2	21.5
1963	36.6	16.7	8.2	4.2	14.1
1964	155.8	213.2			
1965	138.9	128.9	400.0	100.0	133.3
1966	109.3	109.2	150.0	75.0	100.0
1967	100.0	100.0	100.0	100.0	100.0
1968	90.3	101.3	100.0		
1969	87.2	97.4	146.2		
1970	84.3	84.2	130.8		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in Eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "ICC", years 1964–70 "Small Packaged Products"; Freight Commodity Statistics, ICC.

EXHIBIT 25

TREND IN TONNAGE TERMINATED—LCL[1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	9,900	4,403	826	1,085	257
1952	8,909	3,727	702	889	207
1953	7,757	3,260	610	758	185
1954	6,489	2,545	479	574	135
1955	6,612	2,630	492	607	175
1956	6,053	2,425	459	583	122
1957	5,104	2,042	381	494	100
1958	4,119	1,508	273	366	73
1959	3,652	1,332	222	311	59
1960	3,005	1,040	177	245	47
1961	2,423	711	126	153	35
1962	2,034	456	86	51	23
1963	1,626	239	22	10	13
1964	1,470	111	(2)	(2)	(2)
1965	1,341	73	9	6	3
1966	1,065	57	4	6	3
1967	978	49	3	8	3
1968	867	55	14		
1969	870	65	21		
1970	843	55	19		

EXHIBIT 26

INDEX OF TONNAGE TERMINATED—LCL[1]

[1951–63 index (1957–59); 1964–70 index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	230.7	270.6	282.9	278.2	110.8
1952	207.6	229.1	240.4	227.9	89.2
1953	180.8	200.4	208.9	194.4	79.7
1954	151.2	156.4	164.0	147.2	58.2
1955	154.1	161.6	168.5	155.6	75.4
1956	141.1	149.0	157.2	149.5	52.6
1957	118.9	125.5	130.5	126.7	43.1
1958	96.0	92.7	93.5	93.8	31.5
1959	85.1	81.9	76.0	79.7	25.4
1960	70.0	63.9	60.6	62.8	20.3
1961	56.5	43.7	43.2	39.2	15.1
1962	47.4	28.0	29.5	13.1	9.9
1963	37.9	14.7	7.5	2.6	5.6
1964	150.3	226.5			
1965	137.1	149.0	300.0	75.0	100.0
1966	108.9	116.3	133.3	75.0	100.0
1967	100.0	100.0	100.0	100.0	100.0
1968	88.7	112.2	100.0		
1969	89.0	132.7	150.0		
1970	86.2	112.2	135.7		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is inclnded in eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "LCL", years 1964–70 "Small Packaged Products"; Freight Commodity Statistics, ICC.

EXHIBIT 27

TREND IN REVENUES—LCL [1]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	351,432	171,654	35,043	47,554	9,085
1952	351,574	166,175	33,808	45,233	8,472
1953	321,198	153,152	31,953	39,731	7,960
1954	273,541	123,195	25,773	31,563	6,077
1955	201,590	126,105	26,018	32,529	7,146
1956	272,314	123,550	25,199	32,856	5,676
1957	252,045	114,919	22,854	30,894	5,132
1958	212,391	90,667	17,264	24,164	3,966
1959	183,927	77,992	14,137	20,933	3,307
1960	152,891	63,890	11,405	16,502	2,697
1961	125,133	46,874	8,167	11,542	1,915
1962	99,663	30,929	6,007	5,124	1,249
1963	74,856	16,917	2,112	1,054	743
1964	60,965	7,665	(2)	(2)	(2)
1965	51,255	4,265	285	430	130
1966	40,071	3,721	160	391	121
1967	38,190	3,297	116	398	110
1968	34,963	3,438	581		
1969	35,020	3,299	714		
1970	36,488	3,062	669		

EXHIBIT 28

INDEX OF REVENUES—LCL [1]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	162.6	181.6	193.8	187.7	219.7
1952	162.7	175.8	186.9	178.6	204.9
1953	148.6	162.0	176.7	156.9	192.5
1954	126.6	130.3	142.5	124.6	147.0
1955	93.3	133.4	143.9	128.4	172.8
1956	126.0	130.7	139.3	129.7	137.3
1957	116.6	121.6	126.4	122.0	124.1
1958	98.3	95.9	95.5	95.4	95.9
1959	85.1	82.5	78.2	82.6	80.0
1960	70.7	67.6	63.1	65.1	65.2
1961	57.9	49.6	45.2	45.6	46.3
1962	46.1	32.7	33.2	20.2	30.2
1963	34.6	17.9	11.7	4.2	18.0
1964	159.6	232.5			
1965	134.2	129.4	245.7	108.0	118.2
1966	104.9	112.9	137.9	98.2	110.0
1967	100.0	100.0	100.0	100.0	100.0
1968	91.6	104.3	93.1		
1969	91.7	100.1	114.4		
1970	95.5	92.9	107.2		

[1] There are two separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "ICC;" Years 1964–70 "Small Packaged Products"; Freight Commodity Statistics, ICC.

EXHIBIT 29

TREND IN TONNAGE ORIGINATED—PRODUCTS OF AGRICULTURE [1]

[In Thousands]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	140,810	26,770	6,523	5,347	189
1952	138,416	27,834	6,694	5,610	181
1953	131,137	28,628	7,056	5,886	136
1954	131,736	28,277	7,165	5,534	105
1955	133,790	30,657	7,575	6,254	111
1956	138,093	32,437	7,895	6,414	102
1957	137,618	29,135	7,262	5,635	107
1958	146,746	28,012	6,939	5,232	87
1959	145,531	28,333	6,773	4,935	94
1960	150,350	29,588	7,139	5,503	92
1961	153,819	30,572	7,189	6,089	92
1962	155,297	30,648	7,180	6,116	103
1963	160,580	31,684	7,028	6,168	77
1964	129,550	19,381	(2)	(2)	(2)
1965	128,828	17,717	3,406	2,961	7
1966	143,111	17,793	3,286	2,930	9
1967	121,718	16,328	2,844	2,390	4
1968	114,759	15,573	4,679		
1969	118,199	13,207	3,879		
1970	133,264	13,011	2,860		

EXHIBIT 30

INDEX OF TONNAGE ORIGINATED—PRODUCTS OF AGRICULTURE [1]

[1951–63 Index (1957–59); 1964–70 Index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	98.3	93.4	93.3	101.5	196.9
1952	96.6	97.7	95.8	106.5	188.5
1953	91.5	100.5	100.9	111.8	141.7
1954	91.9	99.2	102.5	105.1	109.4
1955	93.4	107.6	108.4	118.4	115.6
1956	96.4	113.8	112.9	121.8	106.3
1957	96.0	102.3	103.9	107.0	111.5
1958	102.4	98.3	99.3	99.3	90.6
1959	101.6	99.4	96.9	93.7	97.9
1960	104.9	103.6	102.1	104.5	95.8
1961	107.3	107.3	102.8	115.6	95.8
1962	108.4	107.6	102.7	116.1	107.3
1963	112.1	111.2	100.5	117.1	80.2
1964	106.4	118.7			
1965	105.8	108.5	119.8	123.9	175.0
1966	117.6	109.0	115.5	122.6	225.0
1967	100.0	100.0	100.0	100	100
1968	94.3	95.4	89.3		
1969	97.1	80.9	74.1		
1970	109.5	79.7	54.6		

[1] There are two separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in Eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "Products of Agriculture"; Years 1965–70 "Farm Products" less "Livestock & Livestock Products" and "Poultry Products"; Freight Commodity Statistics, ICC.

EXHIBIT 31

TREND IN TONNAGE TERMINATED—PROOUCTS OF AGRICULTURE[1]

	Total Class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	144,092	42,787	7,489	10,137	1,530
1952	141,205	41,586	7,238	9,635	1,528
1953	133,052	41,778	7,001	9,711	1,527
1954	133,678	40,909	6,772	9,569	1,540
1955	135,280	42,795	7,281	9,983	1,517
1956	139,570	44,532	7,933	10,209	1,522
1957	138,802	41,398	7,610	9,334	1,464
1958	148,542	40,709	7,279	9,363	1,345
1959	146,118	38,435	6,940	8,546	1,326
1960	150,849	39,587	7,099	8,741	1,297
1961	154,204	40,357	6,993	9,687	1,269
1962	155,503	39,496	6,575	9,416	1,297
1963	159,220	39,728	6,469	8,802	1,329
1964	127,009	24,772	(2)	(2)	(2)
1965	126,149	22,141	3,489	5,096	822
1966	140,531	24,589	3,135	5,854	824
1967	119,342	21,872	2,727	4,744	1,038
1968	112,296	20,087	6,462		
1969	115,917	17,948	6,787		
1970	130,683	17,196	6,473		

EXHIBIT 32

INOEX OF TONNAGE TERMINATEO—PRODUCTS OF AGRICULTURE[1]

[1951–63 Index (1957–59) 1964–70 Index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	99.7	106.5	102.9	111.6	111.0
1952	97.7	103.5	99.5	106.1	110.9
1953	92.1	104.0	96.2	106.9	110.8
1954	92.5	101.8	93.1	105.4	111.8
1955	93.6	106.5	100.1	109.9	110.1
1956	96.6	110.8	109.0	112.4	110.4
1957	96.1	103.0	104.6	102.8	106.2
1958	102.8	101.3	100.0	103.1	97.6
1959	101.1	95.7	95.4	94.1	96.2
1960	104.4	98.5	97.6	96.3	94.1
1961	106.7	100.4	96.1	106.7	92.1
1962	107.6	98.3	90.4	103.7	94.1
1963	110.2	98.9	88.9	96.9	96.4
1964	106.4	113.3			
1965	105.7	101.2	127.9	107.4	79.2
1966	117.8	112.4	115.0	123.4	79.4
1967	100.0	100.0	100.0	100.0	100.0
1968	94.1	91.8	75.9		
1969	97.1	82.1	79.8		
1970	109.5	78.6	76.1		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964 Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in Eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "Products of Agriculture"; years 1964–70 "Farm Products" less "Livestock and Livestock Products" and "Poultry and Poultry Products" Freight Commodity Statistics, ICC.

EXHIBIT 33

TREND IN REVENUE—PROOUCTS OF AGRICULTURE[1]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	1,159,882	261,220	60,319	----------	6,814
1952	1,217,934	273,355	42,518	61,033	7,439
1953	1,182,034	283,782	44,504	63,553	7,534
1954	1,146,564	276,972	42,327	63,309	7,356
1955	1,133,492	283,121	44,790	64,164	7,120
1956	1,184,012	303,831	48,292	68,303	7,348
1957	1,209,237	295,399	48,178	65,914	7,307
1958	1,286,329	302,313	48,894	69,587	6,820
1959	1,226,417	274,424	44,974	62,367	6,497
1960	1,192,422	271,070	46,160	59,747	6,378
1961	1,171,957	270,348	44,065	64,234	6,056
1962	1,163,766	267,744	42,861	64,061	6,016
1963	1,192,557	271,513	43,547	61,438	5,955
1964	931,320	169,672	(2)	(2)	(2)
1965	899,861	156,300	25,643	35,038	3,532
1966	1,006,783	165,306	25,036	39,177	3,380
1967	877,617	151,476	21,774	34,199	4,311
1968	824,279	142,078	50,518		
1969	883,501	138.235	52,806		
1970	1,046,464	146,142	58,102		

EXHIBIT 34

INOEX OF REVENUES—PROOUCTS OF AGRICULTURE[1]

[1951–63 index (1957–59) 1964–70 index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	93.5	89.9	127.4	------------	99.1
1952	98.2	94.0	89.8	------------	108.2
1953	95.3	97.6	94.0	------------	109.6
1954	92.4	95.3	89.4	------------	107.0
1955	91.4	97.4	94.6	------------	103.6
1956	95.4	104.5	102.0	------------	106.9
1957	97.5	101.6	101.6	------------	106.3
1958	103.7	103.4	103.3	------------	99.2
1959	98.9	94.4	95.0	------------	94.5
1960	96.1	93.2	97.5	------------	92.8
1961	94.5	92.3	93.1	------------	88.1
1962	93.8	92.1	90.5	------------	87.5
1963	96.1	93.4	92.0	------------	86.6
1964	106.1	112.0			
1965	102.5	103.2	117.8	102.5	81.9
1966	114.7	109.1	115.0	114.6	76.7
1967	100.0	100.0	100.0	100.0	100.0
1968	93.9	93.8	83.8		
1969	100.7	91.3	87.6		
1970	119.2	96.5	96.4		

[1] There are 2 separate trends (1951–63 and 1964–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: Years 1951–63 "Products of Agriculture"; Years 1964–70 "Farm Products" less "Livestock and Livestock Products" and "Poultry and Poultry Products" Freight Commodity Statistics, ICC.

EXHIBIT 35

TREND IN TONNAGE ORIGINATED—COAL [1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Penn-sylvania	New Haven
1951	439,471	330,723	17,917	40,405	----------
1952	396,573	295,550	17,580	35,866	----------
1953	373,831	275,643	17,537	33,667	----------
1954	331,943	239,779	16,809	28,190	----------
1955	384,312	279,725	18,638	31,536	----------
1956	415,833	302,682	21,300	33,724	----------
1957	402,479	294,875	19,900	32,865	----------
1958	331,262	235,084	17,605	26,632	----------
1959	327,584	232,812	18,575	26,665	----------
1960	321,340	225,876	20,011	24,039	----------
1961	311,847	217,409	20,147	23,868	----------
1962	327,335	228,359	21,427	24,512	----------
1963	348,232	243,650	22,017	26,924	----------
1964	357,685	251,087	(2)	(2)	(2)
1965	363,020	253,195	19,924	30,291	(3)
1966	376,320	258,326	18,539	23,805	(3)
1967	384,583	258,715	17,247	32,384	(3)
1968	379,125	255,489	46,256		
1969	383,292	252,436	47,381		
1970	404,622	255,835	46,372		

EXHIBIT 36

INDEX OF TONNAGE ORIGINATED—COAL [1]

[1951–63 index (1957–59); 1965–70 index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Penn-sylvania	New Haven
1951	124.2	130.1	95.8	104.7	------------
1952	112.1	116.2	94.0	124.9	------------
1953	105.7	108.4	93.8	117.2	------------
1954	93.8	94.3	89.9	98.2	------------
1955	108.6	110.0	99.7	109.8	------------
1956	117.5	119.0	113.9	117.4	------------
1957	113.8	116.0	106.5	114.4	------------
1958	93.6	92.5	94.2	92.7	------------
1959	92.6	91.6	99.4	92.8	------------
1960	90.8	88.8	107.1	83.7	------------
1961	88.1	85.5	107.8	83.3	------------
1962	92.5	89.8	114.6	85.3	------------
1963	98.4	95.8	117.8	93.7	------------
1964	93.0	97.1	------------	------------	------------
1965	94.4	97.9	115.5	93.5	------------
1966	97.9	99.8	107.5	73.5	------------
1967	100.0	100.0	100.0	100.0	------------
1968	98.6	98.8	93.2		
1969	99.7	97.6	95.5		
1970	105.2	98.9	93.4		

[1] There are 2 separate trends (1951–63 and 1965–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

[3] Reports not available for inspection.

Source: 1951–63 Anthracite coal NOS, anthracite coal to breakers and washeries, bituminous coal; 1965–70 bituminous coal and lignite, Freight Commodity Statistics, ICC.

EXHIBIT 37

TREND IN TONNAGE TERMINATED—COAL [1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Pennsyl-vania	New Haven
1951	356,449	265,786	38,627	41,778	4,129
1952	321,965	238,050	36,041	37,890	3,588
1953	302,116	221,707	34,256	36,033	3,762
1954	272,279	195,458	29,717	30,209	2,623
1955	320,395	232,542	30,762	34,362	2,718
1956	353,925	256,604	33,571	35,619	2,992
1957	345,487	252,668	30,882	35,235	3,019
1958	289,343	201,175	27,174	27,450	2,935
1959	280,749	190,761	29,070	28,343	2,896
1960	282,419	189,217	27,384	26,932	2,621
1961	274,377	180,226	26,591	26,032	2,795
1962	288,450	189,795	27,971	26,387	2,777
1963	301,826	196,526	29,692	27,997	2,390
1964	310,241	202,449	(2)	(2)	(2)
1965	315,416	208,070	33,226	33,013	2,316
1966	326,822	211,515	33,970	34,623	2,350
1967	341,310	219,148	35,084	34,169	1,810
1968	326,804	206,099	65,949		
1969	341,420	215,052	65,565		
1970	357,623	218,901	62,642		

EXHIBIT 38

INDEX OF TONNAGE TERMINATED—COAL [1]

[1951–63 Index (1957–59); 1965–70 Index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsyl-vania	New Haven
1951	116.8	123.7	133.0	137.7	140.0
1952	105.5	110.8	124.1	124.9	121.6
1953	99.0	103.2	117.0	118.8	93.6
1954	89.2	91.0	102.3	99.6	88.9
1955	105.0	108.2	105.9	113.2	92.1
1956	116.0	119.4	115.6	117.4	101.4
1957	113.2	117.6	106.3	116.1	102.3
1958	94.8	93.6	93.6	90.5	99.5
1959	92.0	88.8	100.1	93.4	98.2
1960	92.5	88.1	94.3	88.8	88.8
1961	89.9	83.9	91.6	85.8	94.7
1962	94.5	88.3	96.3	87.0	94.1
1963	98.9	91.5	102.2	92.3	81.0
1964	90.9	92.4	------------	------------	
1965	92.4	94.9	94.7	96.6	128.0
1966	95.8	96.5	96.8	101.3	129.8
1967	100.0	100.0	100.0	100.0	100.0
1968	95.7	94.0	92.8		
1969	100.0	98.1	92.3		
1970	104.8	99.9	88.1		

[1] There are 2 separate trends (1951–63 and 1965–70) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production Pocahontas region is included in eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

Source: 1951–63 anthracite coal No. 5, anthracite coal to breakers and washers, bituminous coal; Freight Commodity Statistics, ICC.

EXHIBIT 39

TREND IN REVENUES—COAL[1]

[In thousands]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	1,330,747	1,030,798	(3)	157,145	8,390
1952	1,270,846	975,110	116,942	150,672	7,746
1953	1,199,674	916,195	115,938	145,292	6,215
1954	1,036,320	782,929	99,236	120,172	5,740
1955	1,213,171	931,533	104,759	133,520	5,779
1956	1,389,897	1,077,323	117,265	154,155	6,467
1957	1,395,552	1,094,845	112,257	154,461	6,795
1958	1,150,576	879,054	100,801	124,762	6,685
1959	1,104,579	842,661	104,255	121,251	6,462
1960	1,072,581	815,818	99,304	113,060	1,018
1961	1,044,057	790,180	95,090	114,443	950
1962	1,069,874	814,374	97,548	114,641	5,974
1963	1,103,944	834,112	94,898	112,958	4,626
1964	1,103,493	833,649	(2)	(2)	(2)
1965	1,128,608	852,286	94,387	113,229	3,986
1966	1,129,546	846,122	89,750	114,291	3,972
1967	1,151,847	860,877	(3)	117,572	3,321
1968	1,137,252	849,514	195,559		
1969	1,190,923	869,418	206,529		
1970	1,381,088	979,409	226,005		

EXHIBIT 40

INDEX OF REVENUES—COAL[1]

[1951-1963 index (1957-1959); 1965-1970 index (1967)]

	Total class I railroads	Eastern district railroads	New York Central	Pennsylvania	New Haven
1951	109.3	109.8	----------	117.7	126.2
1952	104.4	103.9	110.6	112.9	116.5
1953	98.6	97.6	109.6	108.8	93.5
1954	85.2	83.4	93.8	90.0	86.4
1955	99.7	99.2	99.0	100.0	86.9
1956	114.2	114.7	110.9	115.5	97.3
1957	114.7	116.6	106.1	115.7	102.2
1958	94.5	93.6	95.3	93.5	100.6
1959	90.8	89.8	98.6	90.8	97.2
1960	88.1	86.9	93.9	84.7	15.3
1961	85.8	84.2	89.9	85.7	14.3
1962	87.9	86.7	92.2	85.9	89.9
1963	90.7	88.8	89.7	84.6	69.6
1964	95.8	96.8	----------	----------	----------
1965	98.0	99.0	----------	96.3	120.0
1966	98.1	98.3	----------	97.2	119.6
1967	100.0	100.0	100.0	100.0	100.0
1968	98.7	98.7			
1969	103.4	101.0			
1970	119.9	113.8			

[1] There are 2 separate trends (1951–1963 and 1965–1970) since the classification was revised in 1964. Prior to that time the classification was based on product consumption. Subsequent data are based on production. Pocahontas region is included in eastern region so that data are comparable.

[2] Individual reports are confidential for 1964.

[3] Data missing.

Source: 1951–63 anthracite coal, 1964 anthracite coal to breakers and washers, bituminous coal; 1965–1970 bituminous coal and lignite; Freight Commodity Statistics.

EXHIBIT 41

METHOD OF TRANSPORTING BITUMINOUS COAL AND LIGNITE FROM MINES

[In thousands]

	Shipped by rail and trucked to rail	Shipped by water and trucked to water	Trucked to final destination	Used at mine	Total production
1970	409,111	81,337	73,975	34,376	602,932
1969	397,863	71,037	66,030	25,575	560,505
1968	396,443	66,885	61,753	20,165	545,245
1967	404,525	66,792	62,003	19,127	552,626
1966	386,958	62,092	67,026	17,806	533,881
1965	371,544	60,289	68,302	11,953	512,088
1964	349,377	59,349	65,532	12,740	486,998
1963	333,989	50,664	60,901	13,374	458,928
1962	307,328	48,106	54,853	11,862	422,149
1961	293,546	46,348	51,044	12,039	402,977
1960	303,865	46,784	52,699	12,164	415,512
1959	300,763	45,954	52,564	12,747	412,028
1958	305,642	43,899	50,605	10,300	410,446
1957	380,471	51.171	50,334	10,728	492,704
1956	390,015	50,732	49,768	10,359	500,874
1955	355,924	47,476	51,607	9,626	464,633
1954	305,918	32,912	44,689	8,187	391,706
1953	362,133	35,648	47,102	12,407	457,290
1952	375,911	27,746	50,231	12,953	466,841
1951	430,387	29,984	58,132	15,162	533,665
1950	417,225	27,583	58,286	13,217	516,311

Source: Vols. 1 and 11, metals, minerals, and fuels, "Minerals Yearbook" for appropriate years, Department of Interior.

EXHIBIT 42

INDEX OF COAL SHIPMENTS BY VARIOUS MODES

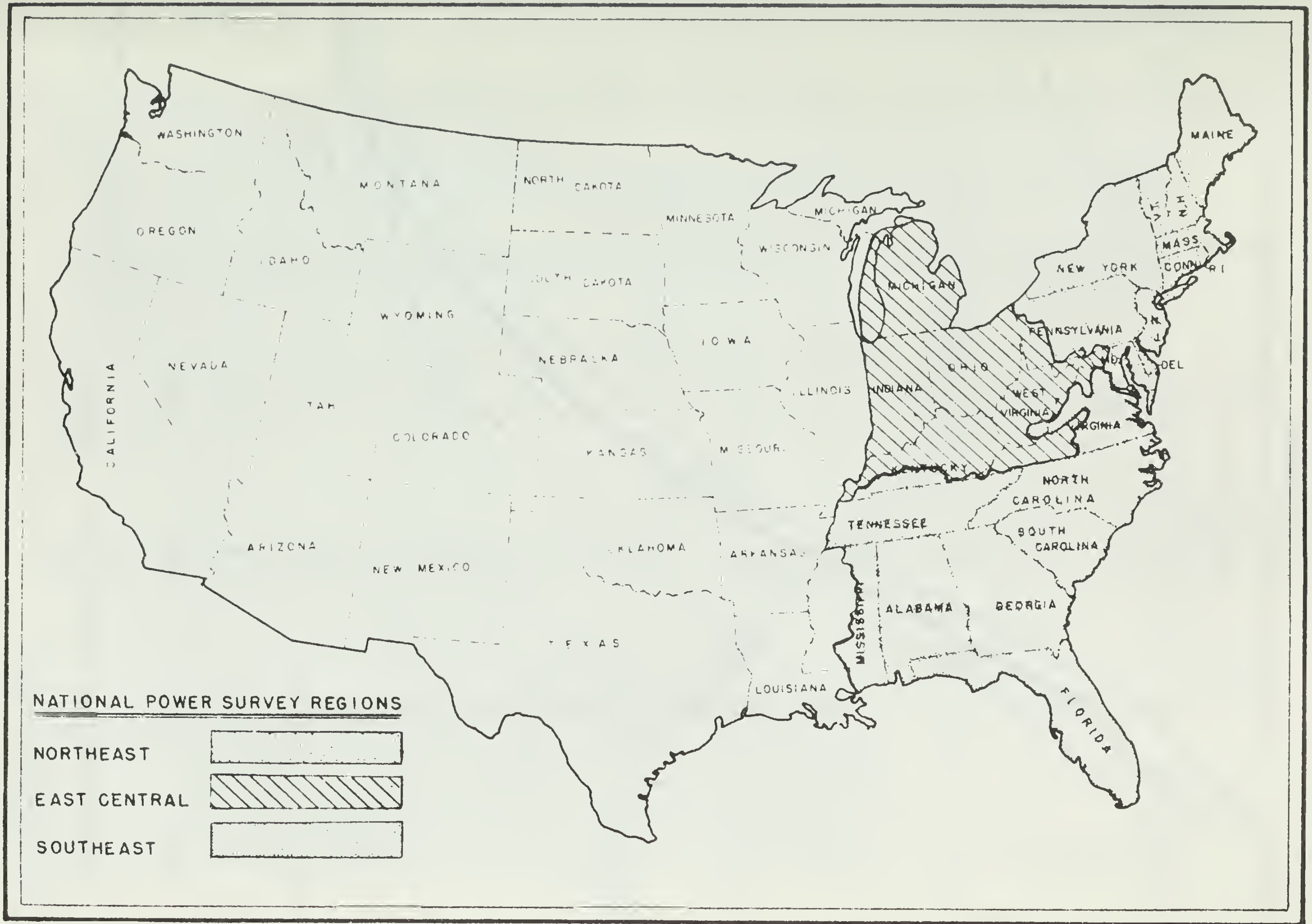
[1957-59=100]

	Shipped by rail and trucked to rail	Shipped by water and trucked to water	Trucked to final destination	Used at mine	Total production
1950	126.8	58.7	113.9	117.0	117.8
1951	130.8	63.8	113.6	134.2	121.7
1952	114.3	59.0	98.2	114.6	106.5
1953	110.1	75.8	92.1	109.8	104.3
1954	93.0	70.0	87.3	72.5	89.4
1955	108.2	101.0	100.9	85.2	106.0
1956	118.6	108.0	97.3	91.7	114.3
1957	115.7	108.9	98.4	95.0	112.4
1958	92.9	93.4	98.9	91.2	93.6
1959	91.4	97.8	102.7	112.8	94.0
1960	92.4	99.5	91.4	107.7	94.8
1961	89.2	98.6	99.8	106.6	91.9
1962	93.4	102.3	107.2	105.0	96.3
1963	101.5	107.8	119.0	118.4	104.7
1964	106.2	126.3	128.1	112.8	111.1
1965	112.9	128.3	133.5	105.8	116.8
1966	117.6	132.1	131.0	157.6	121.8
1967	123.0	142.1	121.2	169.3	126.1
1968	120.5	142.3	120.7	178.5	124.4
1969	120.9	151.1	129.0	226.4	127.9
1970	124.4	173.0	144.6	304.3	137.5

Source: Exhibit 41.

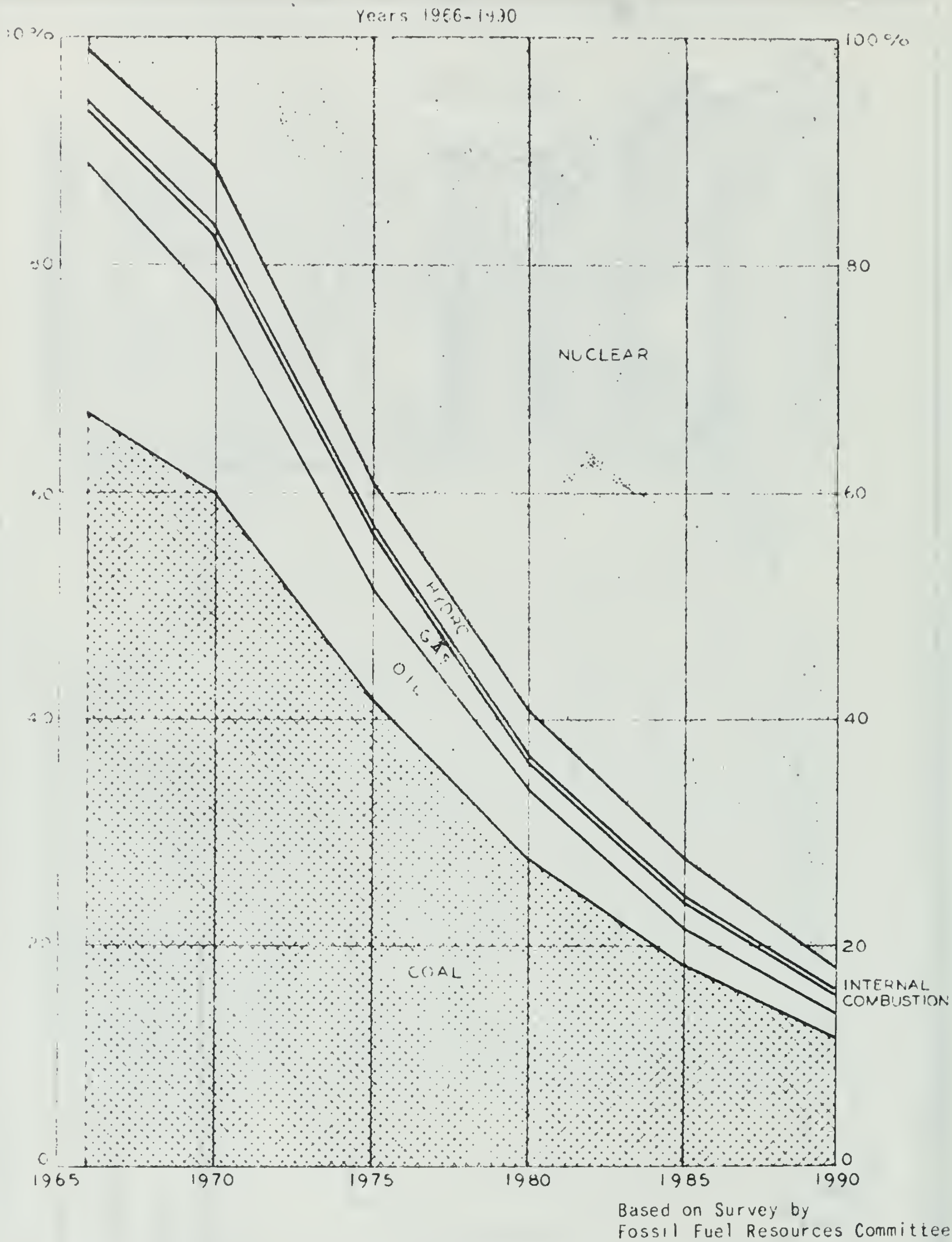
EXHIBIT 43

MAP 1



Source: Federal Power Commission, *National Power Survey, 1970*, p. II-4-viii.

Exhibit 44



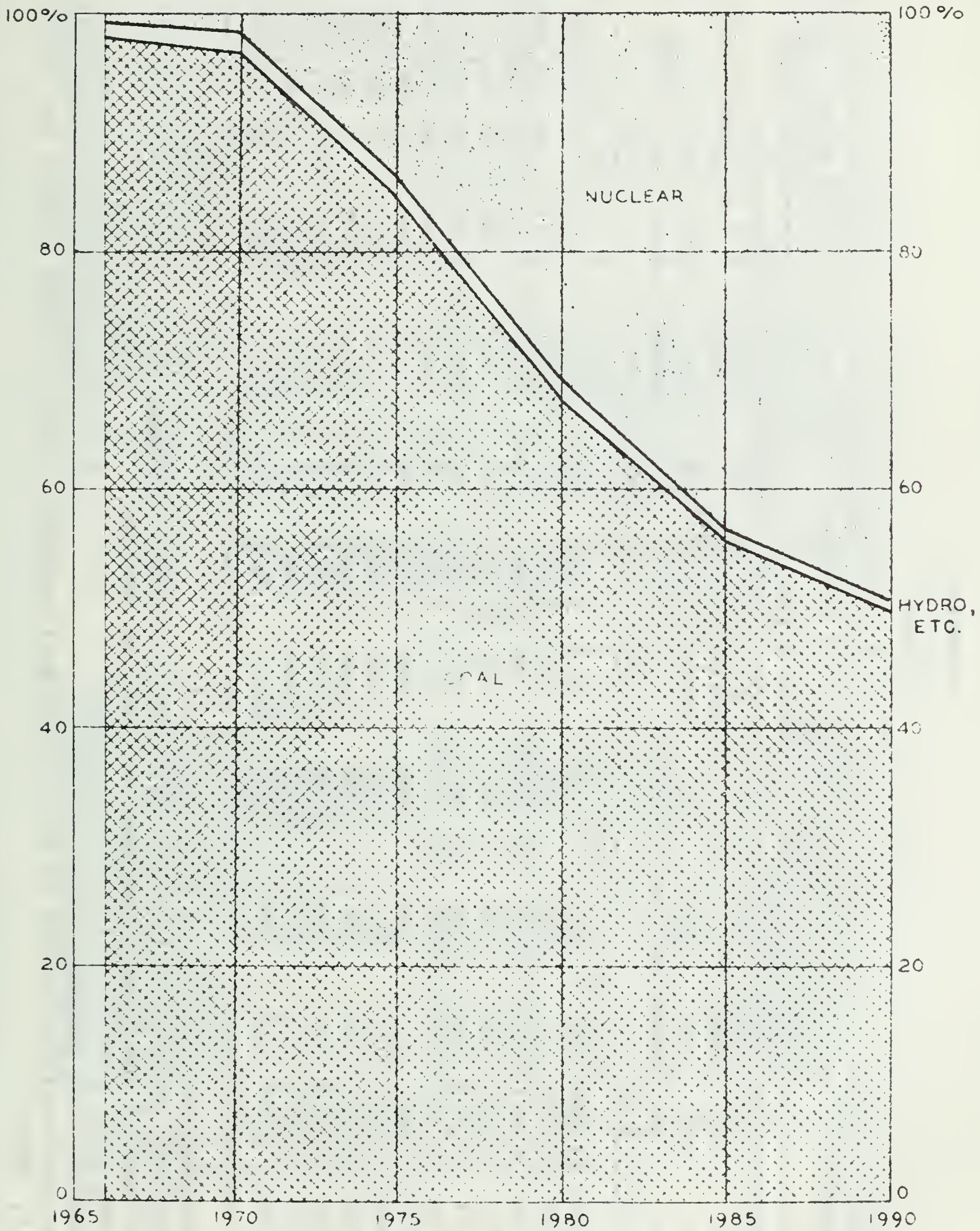
Source: Federal Power Commission, *National Power Survey, 1970*, p. II-4-37.

EXHIBIT 45

PERCENT GENERATION BY TYPE OF FUEL AND HYDRO POWER — CHART 3

EAST CENTRAL REGION

Years 1966-1990



Based on Survey by
Fossil Fuel Resources Committee

Source: Federal Power Commission, *National Power Survey, 1970*, p. II-4-38.

EXHIBIT 46

Table 1

Participation of class I and II motor carriers of general freight in the total estimated intercity volume of regulated small shipment traffic in the U.S. (in thousands of net tons), selected years, 1950 - 1969

Year	Direct carriers						Indirect carriers					Total	Index 1950=100
	(1) Motor LTL class I & II	(2) Rail LCL class I & II	(3) Bus express[1]	(4) Water carrier[2]	(5) Air freight	(6) United Parcel Service[3]	(7) REA Surface	(8) REA Air express	(9) Freight forwarders[4] class A	(10) Parcel post	(11) Air parcel post		
1950	53,405	22,164	168	534	289	NA	2,747	50	4,204	3,475	11	87,047	100.0
1955	54,132	14,045	183	268	389	112	1,995	66	4,697	2,711	18	78,616	90.3
1960	62,144	6,447	202	175	510	386	1,390	70	4,100	2,581	26	78,031	89.6
1961	63,527	5,354	206	139	553	496	1,373	73	4,010	2,362	28	78,121	89.7
1962	68,541	4,473	210	216	647	585	1,340	82	4,311	2,352	31	82,788	95.1
1963	70,794	3,345	215	193	702	775	1,318	84	4,215	2,283	34	83,958	96.4
1964	73,048	2,446	219	69	864	1,064	1,724	96	4,413	2,283	37	86,263	99.1
1965	76,896	2,125	224	351	1,080	1,347	1,845	110	3,994	2,137	43	90,152	103.6
1966	82,048	1,650	229	278	1,242	1,650	1,626	118	4,501	2,107	52	95,501	109.7
1967	80,190	1,512	234	339	1,338	1,815	1,683	121	4,352	2,021	71	93,676	107.6
1968	83,223	1,297	239	297	1,588	2,047	1,285	136	4,503	1,879	123[5]	96,617	111.0
1969	84,505	1,279	243	292	1,740	2,627	1,029	134	4,443	1,878	174[5]	98,344	113.0

NA Not available.
[1]Estimated 2.10 percent increase for each year from 1960 to present.
[2]Includes class A and B water carriers and maritime carriers.
[3]Estimated.
[4]Tons received from shippers.
[5]Includes heavy-weighted pieces of first class mail beginning January 7, 1968 (Public Law 90-206, December 16, 1967).

Source: Interstate Commerce Commission, *Transport Economics*, May, 1971, p. 9.

EXHIBIT 47

COMPARISON OF RELATIVE CHANGES IN TOTAL TONNAGE GENERATED BY THE 24 SHIPPER GROUPS AND THE RAIL SHARE, 1963–67

	Percent change in total tonnage (thousands)			Percent change in rail share			
	1963 [1]	1967	Increase	1963 [1]	1967	Increase	Group
Drugs, paints and other chemical products	55,129	61,169	11.0	45.2	36.7	(8.5)	8
Metal cans and miscellaneous fabricated metal products	12,308	18,408	49.6	27.1	21.3	(5.8)	17
Canned and frozen foods and other food products except meat and dairy products	119,858	155,371	29.6	61.8	56.1	(5.7)	2
Machinery except electrical and industrial	13,919	15,820	13.7	37.6	32.1	(5.5)	19
Textile mill and leather products	12,381	14,495	17.1	13.6	9.1	(4.5)	4
Industrial machinery except electrical	5,786	6,703	15.8	21.3	17.2	(4.1)	18
Furniture, fixtures and miscellaneous manufactured products	8,795	8,712	(.9)	24.0	20.5	(3.5)	12
Primary nonferrous metal products	18,742	22,776	21.5	51.5	48.4	(3.1)	15
Lumber and wood products except furniture	54,648	61,859	13.2	56.5	53.5	(3.0)	11
Primary iron and steel products	120,202	128,975	7.3	52.9	50.3	(2.6)	14
Petroleum and coal products	394,895	417,660	5.8	7.8	5.8	(2.0)	9
Communication products and parts	2,359	2,514	6.6	22.5	21.2	(1.3)	20
Rubber and plastic products	8,583	10,057	17.2	26.3	25.5	(.8)	10
Electrical products and supplies	9,674	12,115	25.2	35.5	34.8	(.7)	21
Fabricated metal products except metal cans and miscellaneous fabricated metal products	15,585	16,668	6.9	23.5	23.0	(.5)	16
Instruments, photographic equipment, watches and clocks	1,388	1,506	8.5	13.6	13.5	(.1)	24
Basic chemicals, plastic materials, synthetic rubber and fibers	74,242	97,619	31.5	52.4	52.4	0	7
Meat and dairy products	35,845	38,675	7.9	29.7	30.2	1.5	1
Apparel and related products	3,689	4,514	22.4	9.8	11.4	1.6	5
Stone, clay, and glass products	164,360	134,313	(18.3)	32.1	35.7	3.6	13
Paper and allied products	64,908	71,677	10.4	50.2	55.5	5.3	6
Motor vehicles and equipment	34,684	36,525	5.3	51.2	57.6	6.4	22
Candy, beverages, and tobacco products	42,239	40,327	(4.5)	23.3	30.2	6.9	3
Transportation equipment, except motor vehicles	3,202	6,159	92.3	35.9	44.3	8.4	23

[1] 1963 data have been adjusted to eliminate tonnage generated by firms employing less than 20 employees. The adjustment was made so that a comparable comparison can be made of 1963 and 1967 data.

Source: Table 10 for each shipper group, 1963 and 1967 Census of Transportation, U.S. Census Bureau.

EXHIBIT 48

COMPARISON OF RELATION CHANGES IN TOTAL TON-MILES GENERATED BY THE 24 SHIPPER GROUPS AND THE RAIL SHARE, 1963–67

	Percent change in total ton-mileage (mill)			Percent change in rail share			
	1963 [1]	1967	Increase	1963 [1]	1967	Increase	Group
Drugs, paints and other chemical products	22,073	19,090	(13.5)	63.7	52.6	(11.1)	8
Furniture, fixtures and miscellaneous manufactured products	4,307	4,961	15.2	42.8	32.6	(10.2)	12
Lumber and wood products, except furniture	39,152	46,658	19.2	87.2	77.8	(9.4)	11
Textile mill and leather products	6,380	6,268	(1.8)	25.3	16.6	(8.7)	4
Machinery except electrical and industrial	8,591	9,126	6.2	52.0	44.4	(7.6)	19
Metal cans and miscellaneous fabricated metal products	4,591	6,148	33.9	42.2	34.7	(7.5)	17
Fabricated metal products except metal cans and miscellaneous fabricated metal products	6,036	6,098	1.0	41.2	34.9	(6.3)	16
Basic chemicals, plastic materials, synthetic rubber and fibers	35,347	43,662	23.5	61.0	55.0	(6.0)	7
Primary nonferras metal products	10,998	13,410	21.9	73.2	67.7	(5.5)	15
Electrical products and supplies	5,695	7,208	26.6	50.9	46.7	(4.2)	21
Rubber and plastic products	4,462	5,307	18.9	38.1	34.5	(3.6)	10
Instruments, photographic equipment, watches, and clocks	993	893	(10.1)	28.8	25.6	(3.2)	24
Primary iron and steel products	33,926	40,438	19.2	61.9	58.8	(3.1)	14
Canned and frozen foods and other food products except meat and dairy products	47,690	62,983	32.1	76.4	73.7	(2.7)	2
Meat and dairy products	15,346	15,540	1.3	48.0	46.0	(2.0)	1
Petroleum and coal products	273,143	289,391	5.9	3.9	3.2	(0.7)	9
Industrial machinery, except electrical	2,752	4,145	50.6	25.8	26.8	1.0	18
Communication products and parts	1,498	1,577	5.3	28.8	30.8	2.0	20
Candy, beverages and tobacco products	13,410	14,835	10.6	54.1	56.6	2.5	3
Apparel and related products	2,112	2,377	12.5	10.2	15.0	4.8	5
Stone, clay and glass products	26,858	26,287	(2.1)	47.2	52.1	4.9	13
Motor vehicles and equipment	15,861	14,944	(5.8)	69.9	75.8	5.9	22
Paper and allied products	26,716	34,966	30.9	71.1	77.3	6.2	6
Transportation equipment except motor vehicles	1,437	2,680	86.5	33.2	47.4	14.2	23

[1] 1963 data has been adjusted to eliminate ton-mileage generated by firms employing less than 20 employees. The adjustment was made so that a comparable comparison can be made of 1963 and 1967 data.

Source: Table 10 for each shipper group, 1963 and 1967 Census of Transportation.

EXHIBIT 49

COMPARISON OF FREIGHT REVENUES GENERATED BY THE VARIOUS MODES DURING THE PERIOD 1954–69

[In millions]

	Freight forwarders	Class I railroads	Eastern district	Pennsylvania	New York Central	New Haven	Class I motor common carriers	Eastern district motor carriers
1954		$7,801	$3,184	$628	$511	$83	$3,108	$1,692
1955	$401	8,538	3,616	718	569	89	3,622	1,949
1956	417	8,951	3,868	767	586	92	3,878	2,103
1957	423	8,929	3,856	765	562	92	3,564	1,896
1958	413	8,071	3,218	635	486	79	2,724	1,399
1959	443	8,312	3,301	673	517	78	4,261	2,230
1960	437	8,025	3,199	638	506	71	3,241	1,665
1961	443	7,739	2,989	614	459	67	3,394	1,752
1962	465	7,991	3,109	649	473	67	5,072	2,609
1963	470	8,146	3,162	643	475	64	3,939	1,980
1964	487	8,455	3,290	676	495	64	4,280	2,161
1965	459	8,836	3,443	703	518	64	4,828	2,394
1966	527	9,281	3,525	719	530	66	5,300	2,542
1967	519	9,130	3,451	702	512	62	5,363	2,552
1968	561	9,750	3,646	1,252		64	6,131	2,968
1969	591	10,346	3,773	1,345			9,801	4,885

EXHIBIT 50

INDEX OF FREIGHT REVENUES

1954		92.4	92.0	90.9	98.0	91.8	88.3	99.8
1955	94.1	101.1	104.5	104.0	109.1	108.5	102.9	108.1
1956	97.9	106.0	111.8	111.0	112.2	114.1	110.2	110.9
1957	99.1	105.8	111.4	110.8	107.7	102.9	101.3	110.7
1958	96.9	95.6	93.0	91.9	93.2	75.9	77.4	95.2
1959	104.0	98.5	95.4	97.4	99.1	121.0	121.1	94.1
1960	102.5	95.1	92.4	92.3	97.0	90.3	92.1	85.9
1961	103.9	91.7	86.7	88.9	87.9	95.1	96.5	81.3
1962	109.0	94.7	89.9	94.	90.7	141.6	144.2	81.4
1963	110.2	96.5	91.4	93.0	91.0	107.5	112.0	76.8
1964	114.3	100.2	95.1	97.9	94.9	117.4	121.7	77.1
1965	107.8	104.7	99.5	101.8	99.4	129.9	137.2	77.6
1966	123.6	109.9	101.9	104.1	101.5	138.0	150.7	80.2
1967	121.7	108.2	99.8	101.7	98.2	138.5	152.5	75.1
1968	131.5	115.5	105.4	103.2		161.1	174.3	77.2
1969	138.6	122.0	109.0	110.8		265.2	278.7	

Source: Transport Statistics in the United States, ICC.

EXHIBIT 51

COMPARISON OF TONNAGE GENERATED BY THE VARIOUS MODES DURING THE PERIOD 1954–69

Class I railroads	Eastern district	Pennsylvania	New York Central	New Haven	Class I motor common carrier	Eastern district motor carrier	Freight forwarders
2, 298	1, 117	169	141	21	271	155	------------
2, 607	1, 305	201	161	23	314	177	5
2, 705	1, 374	211	166	24	330	184	5
2, 552	1, 294	200	151	23	236	125	4
2, 195	1, 031	154	126	20	232	121	4
2, 285	1, 075	164	132	20	268	140	4
2, 281	1, 066	161	133	18	276	143	4
2, 192	997	153	123	18	289	146	4
2, 272	1, 041	161	129	19	321	161	4
2, 359	1, 079	164	133	19	162	88	4
2, 502	1, 155	173	140	19	336	192	4
2, 542	1, 172	177	143	19	419	219	4
2, 645	1, 189	183	139	20	212	113	5
2, 570	1, 150	176	135	18	203	108	4
2, 591	1, 132	286		18	223	120	5
2, 655	1, 139	300			236	126	4

EXHIBIT 52

INDEX OF TONNAGE

98.0	98.5	98.1	103.6	100.1	110.6	120.3	------------
111.2	115.1	116.6	118.1	108.9	127.8	137.9	113.3
115.4	121.2	122.4	121.8	114.1	134.6	143.0	110.6
108.8	114.1	115.8	110.5	110.2	96.1	97.1	103.7
93.6	90.9	89.3	92.7	94.4	94.6	94.2	95.6
97.4	94.8	94.9	96.8	95.4	109.3	108.7	100.7
97.3	94.0	93.4	97.8	88.6	112.3	111.3	98.9
93.5	88.0	88.6	90.2	88.0	117.8	113.2	96.7
96.9	91.8	93.4	94.6	90.4	130.7	125.3	104.0
100.6	95.1	95.2	97.5	89.9	65.9	68.8	101.7
106.7	101.9	100.6	102.7	92.1	137.0	149.3	106.5
108.4	103.4	102.8	104.6	92.7	170.7	170.6	96.4
112.8	104.9	106.2	102.3	95.4	86.5	87.6	108.6
109.6	101.4	101.9	99.1	87.2	82.9	84.2	105.0
110.5	99.9	92.6		85.5	90.8	93.0	108.6
113.2	100.5	97.1			96.0	98.1	107.2

EXHIBIT 53

INTERCITY REVENUE GROWTH OF SELECTED CLASS I MOTOR CARRIERS

[In thousands]

Carrier	1950	1955	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Arkansas Best		(1)	$10,930	$27,355	$25,127	$26,129	$27,071	$24,168	$29,952	$32,333	$38,464	$44,792	$45,825
Associated Transport		$56,291	86,790	86,410	89,582	91,282	96,410	104,839	112,413	112,806	112,058	110,462	115,398
Consolidated Freightways		58,061	121,992	110,882	112,492	135,202	135,386	157,460	200,071	[2] 210,737	257,035	270,637	258,474
McLean		51,646	69,041	72,097	73,923	70,727	78,392	90,405	102,103	110,669	130,782	133,725	156,526
Navajo		10,973	27,863	28,825	30,228	30,478	31,623	34,443	36,234	36,012	40,008	43,218	40,940
PIE		38,015	74,989	78,829	90,513	93,144	[3] 69,206	[3] 71,150	106,075	107,869	127,371	134,870	130,669
Roadway		37,334	74,563	82,387	93,777	103,185	115,566	127,486	142,272	159,766	192,088	210,965	228,190
TIME-DC		38,865	79,177	81,815	86,475	88,548	89,025	109,773	116,062	111,578	118,150	139,306	122,007
Transcon		47,581	45,370	43,991	48,430	62,144	67,151	75,638	66,363	77,985	86,060	93,078	89,290
Werner Continental		11,826	20,160	20,903	24,100	26,338	27,973	31,891	35,149	33,903	(4)	46,055	45,422
Wilson Freight		12,760	22,456	22,697	31,777	31,883	34,823	38,170	40,717	37,567	43,782	50,447	54,146
Yellow		8,613	31,056	64,435	71,896	71,716	74,311	81,148	91,192	93,187	117,780	145,690	161,208

[1] Not available.

[2] Statistics for 1967 include data for Babcock & Lee Transportation Inc. Prior years include Babcock & Lee Petroleum Transporters Inc.

[3] Data for 2 subsidiaries not available.

[4] Statistics for both Continental Transportation Lines Inc. and Werner Transportation Co. were not available in Trinc's Blue Book.

Source: Trinc's Blue Book of the Trucking Industry, Trinc's Associates Ltd.; Washington, D.C. Trinc's Red Book of the Trucking Industry, Trinc's Associates Ltd.; Washington, D.C.

EXHIBIT 54

CONSOLIDATED FREIGHTWAYS

with the people and the places to serve you better.

Source: National Highway Carriers Directory, Inc., *National Highway and Airway Carriers and Routes,* Spring 1971, pg. 278.

EXHIBIT 55

Special to freight expediters

Here's the newest P·I·E coast-to-coast route map. Remember, when you're shipping to any of the more than 3,000 points served by P·I·E, it's your sure line.

Coast to Coast

the Fine Line of difference—

General Office · Pacific Intermountain Express Co.
1417 Clay Street · Oakland, California 94612

Motor carriers not now listed, are invited to list their corporate setup, direct points, terminals and terminal telephones in the directory. There is no charge for this service.

Source: National Highway Carriers Directory, Inc., *National Highway and Airway Carriers and Routes,* Spring 1971, pg. 332.

Exhibit 56

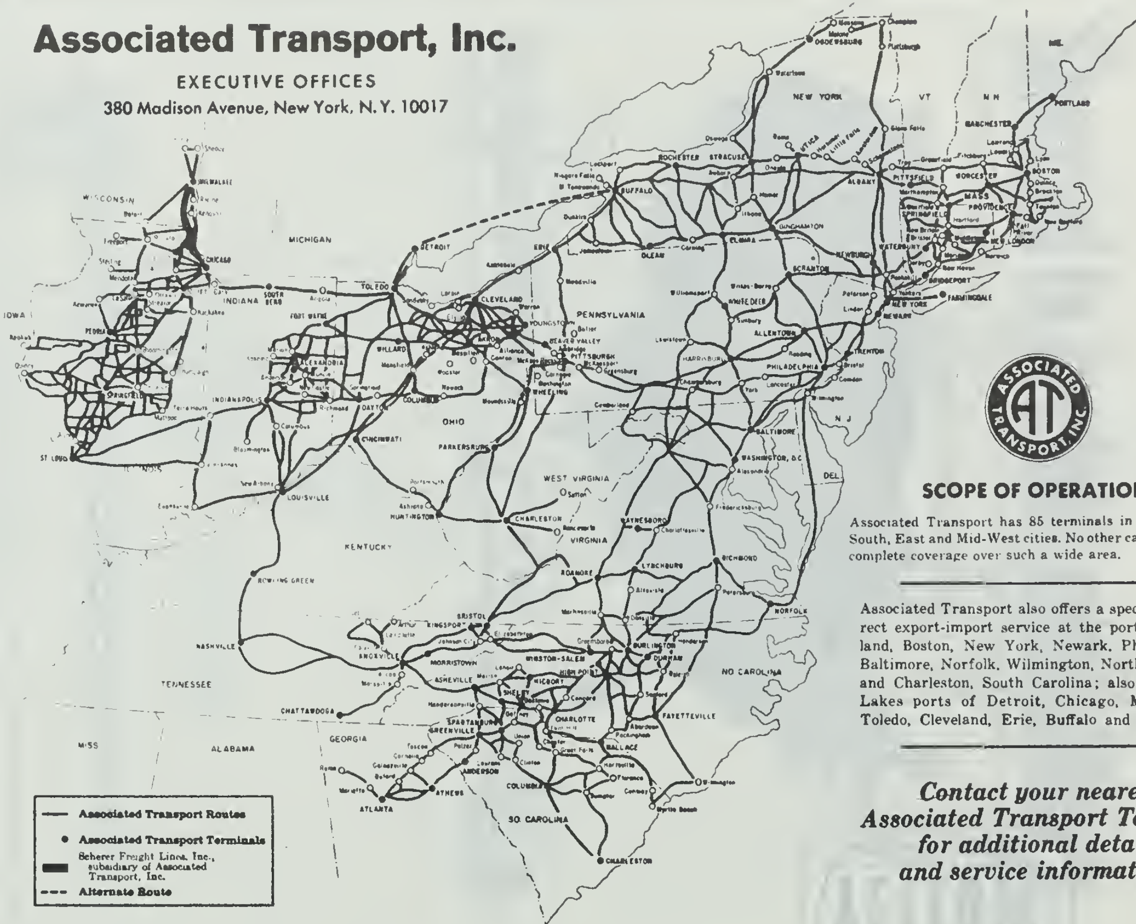
Source: National Highway Carriers Directory, Inc., *National Highway and Airway Carriers and Routes*, Spring 1971, pg. 366.

EXHIBIT 57

Associated Transport, Inc.

EXECUTIVE OFFICES

380 Madison Avenue, New York, N.Y. 10017



SCOPE OF OPERATIONS

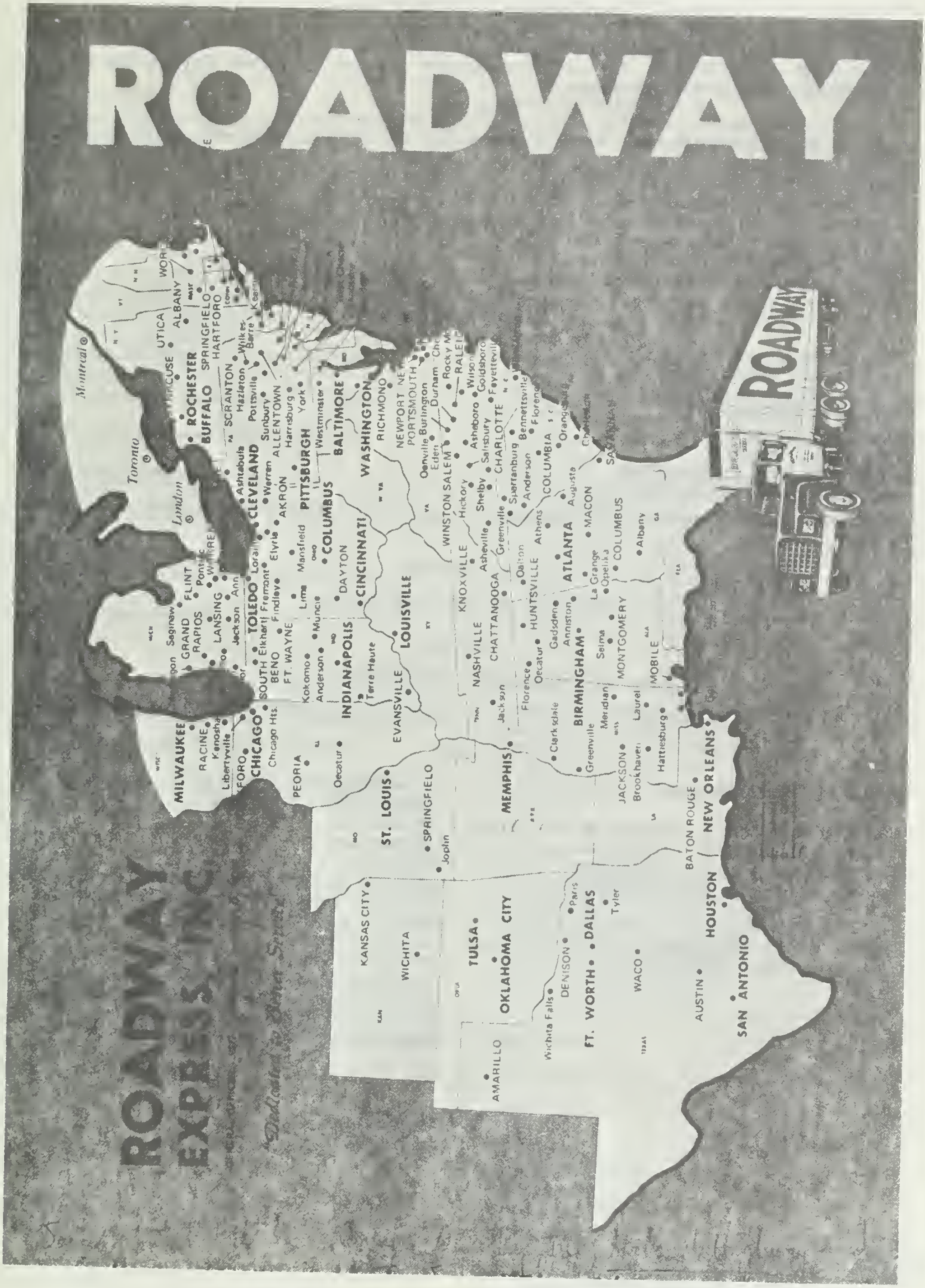
Associated Transport has 85 terminals in major North, South, East and Mid-West cities. No other carrier has such complete coverage over such a wide area.

Associated Transport also offers a specialized, direct export-import service at the ports of Portland, Boston, New York, Newark, Philadelphia, Baltimore, Norfolk, Wilmington, North Carolina, and Charleston, South Carolina; also the Great Lakes ports of Detroit, Chicago, Milwaukee, Toledo, Cleveland, Erie, Buffalo and Rochester.

Contact your nearest Associated Transport Terminal for additional details and service information.

Source: National Highway Carriers Directory, Inc., *National Highway and Airway Carriers and Routes*, Spring 1971, pg. 278.

EXHIBIT 58



Source: Airway Carriers and Routes; Spring 1971, p. 342.

Exhibit 59

Merger, Acquisition History of Selected Carriers, 1955–1970

YELLOW FREIGHT SYSTEM, INC.

1970 Norwalk Truck Lines
1968 Watson-Wilson Transportation System
1959 Central States Freight Service (subsequently changed to Yellow Forwarding Co.)
1956 Michigan Motor Freight Lines

TIME DC

1969 DC International-Seattle Motor Express Inc. (carriers merged with Time Freight, Inc.)
1968 Texas-Arizona Motor Freight, Inc.
1963 Super Service Motor Freight Co.
1962 Constructors Transport Co.
1960 American Transfer Co.
1959 Powell Bros. Truck Lines, Inc.
1956 Southeastern Truck Lines, Inc.

PACIFIC INTERMOUNTAIN EXPRESS

1967 Lower Transportation, Inc.
1967 Siebert Truck Service
1965 All States Freight, Inc.
1963 Tyro Industries, Inc.
1959 Bond Trucking Co.
1958 Union Transfer Co.
1956 M&M Fast Freight Lines
1955 Orange Transportation Co.

Source: *Trinc's Red Book of the Trucking Industry,* Trinc's Associates Ltd., Washington, D.C.

Exhibit 59A

[Ex Parte No. 270 (Sub-No. 2)]

APPENDIX A

Shippers Evidence of Service Deficiencies

Shipper	Nature of complaint of deficient service
	Coal
Toledo Edison Company	car shortages excessive time in transit
Consolidated Edison Company of New York	car shortages
Niagara Mohawk Power Company	car shortages
The Property Owners' Committee	car shortages
Niagara Mohawk Power Company	delays in pickup of loaded cars delays en route for lack of motive power untimely and late deliveries
Public Service Electric and Gas Company	car shortages
Rochester Gas and Electric Co.	lack of motive power inadequate roadbed maintenance inadequate supervision of local operations tendency of employees to thwart attempts of management to improve service

[Exhibit 59A—Continued]

Grain and grain products

The Minneapolis Grain Exchange	unfit cars (most common defects: holes or leaks; defective doors; missing doors; defective slides; odors; foreign material in cars including cement, coal dust, fertilizer, lime, meal, oil, and sand; wrong type of car; and cars which could not be sealed)
Agway, Inc.	erratic transit times
New England Grain and Feed Council, Inc.	erratic and excessive transit times
General Mills	unfit cars (shipper at own expense performs routine cleaning, trash removal, patching and reconditioning rather than reject cars because of car shortage)
	erratic transit times
Peavey Company	erratic transit times
	delays in switching to linehaul carrier
Maryland State Board of Agriculture	erratic transit times
Louis Dreyfus Corporation	erratic and excessive transit times
CPC International, Inc.	erratic and excessive transit times
Cargill, Incorporated	erratic transit times
Southern States Cooperative, Inc.	erratic and excessive transit times
Pillsbury Company	excessive transit times
Archer-Daniels Midland Company	delays in moving leased cars into linehaul service
Southern States Cooperative, Inc.	terminal delays in switching and interchange of cars
Continental Grain Company	delays in delivering loaded cars and in pick-up of empty cars
Garvey, Inc.	terminal delays and improper switching of inbound shipments at certain points and of outbound cars at other points
Board of Trade of Kansas City, Mo.	terminal delays in delivering inbound shipments to grain elevators
Anheuser-Busch	increased turn-around time on shipper's privately-owned cars

Liquefied petroleum gas

Kendall Refining Company	erratic and excessive transit times
	bunching of cars
Pennsylvania Refining Company	erratic and excessive transit times
	bunching of cars
Quaker State Oil Refining Corporation	excessive transit times caused by delays en route

Lumber and paper

Southern States Cooperative	terminal delays
The Fibre Box Association	inadequate car supply
	excessive freight loss and damage
	erratic transit times
Simpson Timber Co.	excessive freight claims
The Georgia-Pacific Corporation	excessive delivery time
Boise Cascade Corporation	excessive transit time

Aluminum ores and products

Reynolds Metals Co.	excessive and erratic transit times

Scrap iron and steel

Institute of Iron and Steel Scrap Shippres	excessive transit times
	terminal delays
	car shortages
	bad-order cars
	bunching of cars
	carriers increasing their tonnage capacity, without commensurate increase in the cubic carrying capacity of their cars

[Exhibit 59A—Continued]

General

Shippers of fresh fruits and vegetables from the West; and Northwest Horticultural Counsel	erratic and excess transit times car shortages, particularly refrigerator cars
Shippers of cement and aggregates	car shortages unfit cars in need of repairs and cleaning
United States Brewers Association	erratic and excess transit times terminal delays
Carling Brewing Company	terminal delays
Adolph Coors Brewing	increased turn-around time
Olympia Brewing Company	increased turn-around time
Shippers of chemicals and allied products	car shortages outmoded labor contracts excessive and unreliable transit times inadequate terminal, interchange and car repair facilities
Kraft Foods	erratic and inconsistent transit times
Swift and Co.	erratic and excessive transit time
Shippers of fertilizer and potash	erratic and excessive transit times

EXHIBIT 60

COMPARISON OF OPERATING RATIOS ACHIEVED BY INTERCITY MOTOR CARRIER SUBSIDIARIES CONTROLLEO BY THE PENN CENTRAL ANO THOSE ACHIEVED BY ALL CLASS I INTERCITY COMMON CARRIERS 1965–70

	1965	1966	1967	1968	1969	1970
Merchants Trucking Co.[1]	90.6	90.7	91.8	93.7	93.5	95.2
New England Transportation Co.	101.7	99.4	100.3	99.3	96.5	103.1
All class I intercity common carriers	94.7	94.6	96.4	95.2	96.0	96.6

[1] Merchants was merged into Pennsylvania Truck Lines, Inc., as of January 1, 1972.

Source: "Trinc's Blue Book of the Trucking Industry," Trinc's Associates, Ltd. Washington, O.C.

EXHIBIT 61

COMPARISON OF REVENUE GROWTH ACHIEVED BY INTERCITY MOTOR CARRIER SUBSIOIARIES CONTROLLED BY THE PENN CENTRAL AND THOSE ACHIEVED BY ALL CLASS I INTERCITY COMMON CARRIERS, 1965–70

[1967 equals 100]

	Merchants Trucking Co.[1]		New England Transportation Co.		All class I intercity common carriers	
	Revenues (thousands)	Index	Revenues (thousands)	Index	Revenues (thousands)	Index
1965	$516	93.0	$3,319	86.5	$5,053,856	93.0
1966	620	111.7	3,633	94.6	5,574,885	111.7
1967	555	100.0	3,839	100.0	5,914,296	100.0
1968	724	130.5	4,040	105.2	6,392,211	130.5
1969	877	158.0	4,451	115.9	7,140,177	158.0
1970	885	159.5	4,560	118.8	7,312,208	159.5

[1] Merchants has been merged into Pennsylvania Truck Lines, Inc. as of Jan. 1, 1972.

Source: Trinc's Blue Book of the Trucking Industry, Trinc's Associates Ltd., Washington, O.C. for the individual carriers.

EXHIBIT 62

COMPARISON OF OPERATING RATIOS ACHIEVEO BY LOCAL MOTOR CARRIER SUBSIDIARIES CONTROLLEO BY THE PENN CENTRAL AND THOSE ACHIEVED BY ALL GENERAL FREIGHT LOCAL CARRIERS 1965–70

	1965	1966	1967	1968	1969	1970
New York Central Transport [1]	82.5	73.1	82.5	85.3	84.1	90.9
Pennsylvania Truck Lines Inc.[1]	93.3	90.8	97.1	99.4	99.6	103.2
Penntruck Co[1]	82.4	80.9	93.1	97.1	93.9	95.8
All General Freight Local Carriers	95.7	95.8	96.2	95.4	95.1	96.9

[1] These carriers together with Merchants Trucking Co. have been merged into Pennsylvania Truck Lines, Inc. as of January 1, 1972.

Source: "Trinc's Blue Book of the Trucking Industry," Trinc's Associates, Ltd., Washington, O.C.—for appropriate years.

EXHIBIT 63

COMPARISON OF REVENUE GROWTH ACHIEVED BY LOCAL MOTOR CARRIER SUBSIDIARIES CONTROLLED BY THE PENN CENTRAL AND THOSE ACHIEVED BY ALL GENERAL FREIGHT LOCAL CARRIERS, 1965–70

[1967 equals 100]

	New York Central Transport [1]		Pennsylvania Truck Lines, Inc. [1]		Penntruck Co. [1]		All general freight local carriers	
	Revenues (thousands)	Index	Revenues (thousands)	Index	Revenues (thousands)	Index	Revenues (thousands)	Index
1965	$15,259	65.5	$8,767	97.4	$1,334	96.3	$597,200	84.8
1966	19,522	83.8	9,009	100.1	1,406	101.5	675,018	95.8
1967	23,291	100.0	9,001	100.0	1,385	100.0	704,494	100.0
1968	36,424	156.4	8,747	97.2	1,796	129.7	714,282	101.4
1969	53,723	230.7	9,955	110.6	2,287	165.1	556,236	79.0
1970	34,358	147.5	9,822	109.1	2,417	174.5	317,607	45.1

[1] These carriers together with Merchants Trucking Co. have been merged into Pennsylvania Truck Lines, Inc. as of Jan. 1, 1972.

Source: Trinc's Blue Book of the Trucking Industry, Trinc's Associates Ltd., Washington, D.C., appropriate year.

EXHIBIT 64

COMPARISON OF REVENUES AND PRODUCTION GENERATED BY U.S. PIPELINES VERSUS BUCKEYE

[Revenues and barrels in thousands]

	Buckeye pipelines		U.S. pipelines	
	Revenues	Barrels [1]	Revenues	Barrels [1]
1969	$34,645	343,111	$1,103,258	7,741,815
1968	34,264	334,843	1,022,962	7,268,759
1967	31,763	303,011	994,520	6,800,424
1966	30,991	290,793	941,138	6,238,192
1965	28,812	280,307	903,817	5,863,651
1964	28,288	270,595	865,079	5,565,112
1963	27,751	266,849	840,260	5,321,661
1962	25,696	249,322	810,605	5,108,562
1961	24,833	238,121	786,718	4,923,296
1960	21,651	232,765	770,417	4,783,042
1959	21,088	230,251	765,232	4,659,340
1958	19,684	210,225	720,670	4,316,721
1957	20,116	223,669	729,952	4,472,426
1956	20,231	233,780	737,386	4,457,667
1955	17,560	205,908	677,605	4,038,990

[1] Represents total delivered out of system.

Source: Part 6, Transport Statistics in the United States, ICC.

EXHIBIT 65

COMPARISON OF REVENUES GENERATED BY U.S. PIPELINES VERSUS BUCKEYE (THOUSANDS)

	U.S. pipelines (1957–59=100)	Buckeye		U.S. pipelines (1957–59=100)	Buckeye
1955	91.7	86.5	1963	113.8	136.7
1956	99.8	99.7	1964	117.1	139.4
1957	98.8	99.1	1965	122.4	142.0
1958	97.6	97.0	1966	127.4	152.7
1959	103.6	103.9	1967	134.6	156.5
1960	104.3	106.7	1968	138.5	168.8
1961	106.5	122.4	1969	149.4	170.7
1962	109.7	126.6			

Source: Exhibit 64.

EXHIBIT 66

COMPARISON OF BARRELS[1] GENERATED BY U.S. PIPELINES VERSUS BUCKEYE

[1957–59=100]

	U.S. Pipelines	Buckeye		U.S. Pipelines	Buckeye
1955	90.1	93.0	1963	118.7	120.5
1956	99.4	105.6	1964	124.1	122.2
1957	99.8	101.0	1965	130.8	126.6
1958	96.3	95.0	1966	139.2	131.4
1959	103.9	104.0	1967	151.7	136.9
1960	106.7	105.1	1968	162.1	151.2
1961	109.8	107.6	1969	172.7	155.0
1962	114.0	112.6			

[1] Represents total barrels delivered out of the system.

Source: Exhibit 64.

EXHIBIT 67

COMPARISON OF PASSENGER REVENUES DURING THE PERIOD 1953–69

	Class I railroads	Eastern district	Pennsylvania	New York Central	New Haven
1951					
1952					
1953	$841,961,640	$458,672,615	$142,097,087	$117,117,505	$51,407,538
1954	767,282,708	425,280,542	126,503,784	106,568,158	49,886,419
1955	742,944,763	413,600,884	121,156,635	100,663,475	47,773,559
1956	756,582,035	422,971,597	123,782,131	98,593,509	51,518,043
1957	735,339,490	414,203,756	121,739,972	88,453,741	53,661,892
1958	675,295,593	378,043,295	108,139,738	78,294,208	50,595,456
1959	651,168,032	355,831,449	103,952,598	69,709,922	45,441,102
1960	640,268,065	344,593,359	99,849,348	67,936,647	44,441,369
1961	624,688,484	335,619,141	99,138,710	61,304,644	42,515,891
1962	619,056,203	326,012,206	93,164,417	59,355,482	41,277,646
1963	588,104,351	316,749,047	90,322,234	56,266,420	41,137,020
1964	577,909,949	315,222,560	88,157,634	54,419,033	40,897,240
1965	553,056,215	298,965,497	82,956,647	51,537,669	38,659,273
1966	543,632,408	292,784,552	81,046,658	48,614,535	37,652,322
1967	485,369,136	269,942,174	73,963,433	40,998,404	36,483,609
1968	444,334,454	258,406,090	105,087,068		36,371,646
1969	438,666,911	265,326,514	147,111,527		

EXHIBIT 68

INDEX OF PASSENGER REVENUES DURING THE PERIOD 1953–69

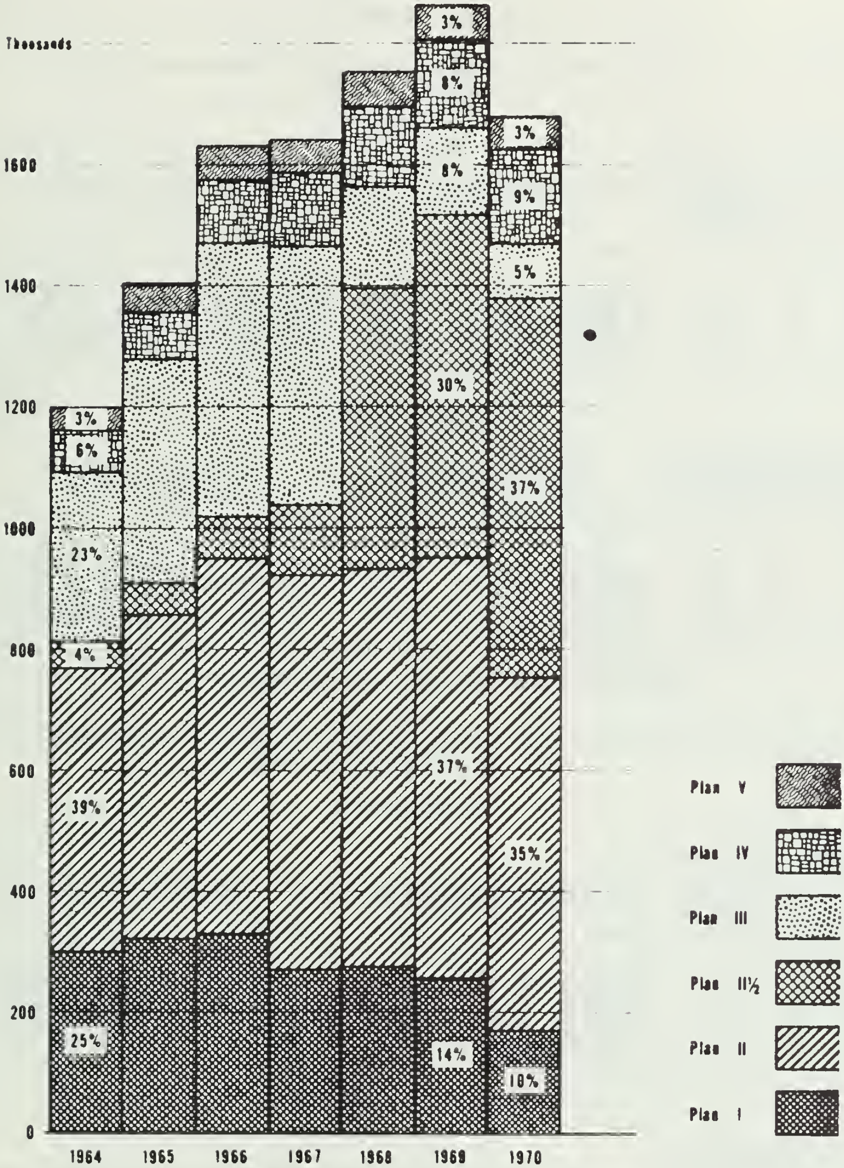
[1957–59=100]

	Class I railroads	Eastern district	Pennsylvania	New York Central	New Haven
1951					
1952					
1953	122.5	119.8	127.7	148.6	103.0
1954	111.6	111.1	113.7	135.2	100.0
1955	108.1	108.1	108.9	127.7	95.7
1956	110.1	110.5	111.2	125.1	103.2
1957	107.0	108.2	109.4	112.2	107.5
1958	98.2	98.8	97.2	99.3	101.4
1959	94.7	93.0	93.4	88.4	91.1
1960	93.2	90.0	89.7	86.2	89.1
1961	90.9	87.7	89.1	77.8	85.2
1962	90.1	85.2	83.7	75.3	82.7
1963	85.6	82.8	81.2	71.4	82.4
1964	84.1	82.4	79.2	69.0	82.0
1965	80.5	78.1	74.5	65.4	77.5
1966	79.1	76.5	72.8	61.7	75.5
1967	70.6	70.5	66.5	52.0	72.1
1968	64.6	67.5	55.3		72.9
1969	63.8	69.3	77.4		

Source: Exhibit 67, Transport Statistics in the United States for appropriate years, ICC; Exhibit 68, Exhibit 67.

EXHIBIT 69

PIGGYBACK TRAILER AND CONTAINER TERMINATIONS
REPORTED BY CLASS I RAILROADS
BY PLAN, 1964–1970



Source Bureau of Economics, Statement No 66-1, Piggyback Traffic Characteristics (1966) and Transport Economics.
Source: Interstate Commerce Commission, *Annual Report*, 1971, p. 138.

APPENDIX C

TABLE C-1.—NORTH-SOUTH TRAFFIC AND REVENUE AS A SHARE OF TOTAL TRAFFIC AND REVENUE IN OFFICIAL AND SOUTHERN TERRITORIES, 1953-69

OFFICIAL TERRITORY

	Traffic and revenue between official territory and United States			Traffic and revenue between official territory and southern territory			Official, southern traffic and revenue as a percent of official, United States traffic and revenue.		
	Cars	Tons	Revenue	Cars	Tons	Revenue	Cars	Tons	Revenue
1953	18,139,700	781,319,900	$4,949,071,000	1,872,500	64,401,400	$710,880,400	10.3	8.2	14.4
1963	13,465,100	629,358,700	4,256,912,200	1,485,700	60,962,900	610,794,700	11.0	9.7	14.4
1965	13,942,300	683,019,400	4,613,492,800	1,651,000	71,607,000	709,305,700	11.8	10.5	15.4
1966	13,959,700	693,051,600	4,766,721,900	1,667,900	72,122,700	742,988,200	11.9	10.4	15.6
1969	12,564,300	663,316,600	4,919,710,100	1,850,600,	88,199,900	915,403,300	14.7	13.3	18.6

SOUTHERN TERRITORIES

	Traffic and revenue between southern territory and United States			Traffic and revenue between southern territory and official territory			Southern, official traffic and revenue as a percent of southern, United States traffic and revenue		
	Cars	Tons	Revenue	Cars	Tons	Revenue	Cars	Tons	Revenue
1953	6,072,400	238,584,600	$1,564,975,200	1,872,500	64,401,400	$710,880,400	30.8	27.0	45.4
1963	5,348,400	255,018,300	1,506,955,100	1,485,700	60,962,900	610,794,700	27.8	23.9	40.5
1965	5,854,700	292,247,700	1,702,196,100	1,651,000	71,607,000	709,305,700	28.2	24.5	41.7
1966	5,956,700	304,723,990	1,796,711,600	1,667,900	72,122,700	742,988,200	28.0	23.7	41.4
1969	6,959,100	354,740,400	2,183,993,800	1,850,600	88,199,900	915,403,300	26.6	24.9	41.9

Source: Interstate Commerce Commission and Department of Transportation, carload waybill statistics.

TABLE C-2.—TRANSCONTINENTAL TRAFFIC AND REVENUE AS A SHARE OF TOTAL TRAFFIC AND REVENUE IN OFFICIAL AND MONTAIN-PACIFIC TERRITORIES, 1953-69

OFFICIAL TERRITORY

	Traffic and revenue between Official Territory and United States			Traffic and revenue between Official Territory and Mountain-Pacific Territory			Official, Mountain-Pacific traffic and revenue as a percent of Official-United States traffic and revenue		
	Cars	Tons	Revenue	Cars	Tons	Revenue	Cars	Tons	Revenue
1953	18,139,700	781,319,900	$4,949,071,000	748,600	18,348,100	$720,742,700	4.1	2.3	14.6
1963	13,465,100	629,358,700	4,256,912,200	692,400	19,127,100	767,893,600	5.1	3.0	18.0
1965	13,942,300	683,019,400	4,613,492,800	718,900	21,971,700	848,891,400	5.2	3.2	18.4
1966	13,959,700	693,051,600	4,766,721,900	749,700	23,126,300	886,131,300	5.4	3.3	18.6
1969	12,564,300	663,316,600	4,919,710,100	660,100	21,638,700	879,163,900	5.3	3.3	17.9

MOUNTAIN-PACIFIC TERRITORY

	Traffic and revenue between Mountain-Pacific territory and United States			Traffic and revenue between Mountain-Pacific Territory and Official Territory			Mountain-Pacific traffic and revenue as a percent of Mountain-Pacific-United States traffic and revenue		
	Cars	Tons	Revenue	Cars	Tons	Revenue	Cars	Tons	Revenue
1953	4,299,700	150,444,400	$2,059,682,100	748,600	18,348,100	$720,742,700	17.4	12.2	35.0
1963	3,487,700	141,223,100	2,088,850,700	692,400	19,127,100	767,893,600	19.9	13.5	36.8
1965	3,818,300	171,025,300	2,316,658,400	718,900	21,971,700	848,891,400	18.8	12.8	36.6
1966	3,868,000	174,935,700	2,436,098,100	749,700	23,126,300	886,131,300	19.3	13.2	36.4
1969	3,649,000	175,942,900	2,581,263,100	660,100	21,638,700	879,163,900	18.1	12.3	34.1

Source: Interstate Commerce Commission and Department of Transportation, Carload Waybill Statistics.

TABLE C-3.—VOLUME AND DIRECTIONAL FLOW OF OFFICIAL-SOUTHERN TRAFFIC, 1953-69

	Carloads	Percent	Tons	Percent	Revenue	Percent
1953:						
Northbound	1,224,100	65	47,150,600	73	$424,549,200	60
Southbound	648,400	35	17,250,800	27	286,331,200	20
Total	1,872,500	100	64,401,400	100	710,880,400	100
1963:						
Northbound	859,100	58	38,485,900	63	347,442,300	57
Southbound	626,600	42	22,477,000	37	263,352,400	43
Total	1,485,700	100	60,962,900	100	610,794,700	100
1965:						
Northbound	945,200	57	45,292,100	63	394,330,500	56
Southbound	705,800	43	26,314,900	37	314,975,200	44
Total	1,651,000	100	71,600,700	100	709,305,700	100
1966:						
Northbound	947,900	57	44,669,900	62	413,199,800	56
Southbound	720,000	43	27,452,800	38	329,788,400	44
Total	1,667,900	100	72,122,700	100	742,988,200	100
1969:						
Northbound	945,700	51	45,354,300	51	474,675,100	52
Southbound	904,900	49	42,765,600	49	440,728,200	48
Total	1,850,600	100	88,119,900	100	915,403,300	100

Source: Interstate Commerce Commission and Department of Transportation, Carload Waybill Statistics.

TABLE C-4.—VOLUME AND DIRECTIONAL FLOW OF OFFICIAL-TRANSCONTINENTAL TRAFFIC, 1953-69

	Carloads	Percent	Tons	Percent	Revenue	Percent
1953:						
Eastbound	456,600	61	12,293,200	67	$381,993,600	53
Westbound	292,000	39	6,054,900	33	338,749,100	47
Total	748,600	100	18,348,100	100	720,742,700	100
1963:						
Eastbound	401,600	58	12,815,200	67	406,983,600	53
Westbound	290,800	42	6,311,900	33	360,910,000	47
Total	692,400	100	19,127,100	100	767,893,600	100
1965:						
Eastbound	409,800	57	14,501,300	66	449,912,400	53
Westbound	309,100	43	7,470,400	34	398,979,000	47
Total	718,900	100	21,971,700	100	848,891,400	100
1966:						
Eastbound	427,300	57	15,263,400	66	469,649,600	53
Westbound	322,400	43	7,862,900	34	416,481,700	47
Total	749,700	100	23,126,300	100	886,131,300	100
1969:						
Eastbound	384,700	58	14,443,500	67	477,367,800	54
Westbound	275,400	42	7,195,200	33	401,796,100	46
Total	660,100	100	21,638,700	100	879,163,900	100

Source: Interstate Commerce Commission and Department of Transportation, Carload Waybill Statistics.

Table C–5

Chronology of Southern and Transcontinental Divisions Cases

official—southern divisions on further hearing (1959–65)

November 1, 1956: Petition of Eastern Roads for further hearing and Modification of 1953 Order.
November 26, 1956: Notice by ICC—Date for filing replies deferred until further notice.
May 1, 1959: Reply of Southern Lines to Petition for Reopening.
July 20, 1959: ICC Order Reopening for Further Hearing.
November 16, 1959, to February 13, 1961: Hearings on intermittent schedule for cross-examination of witnesses presenting Verified Statements as exhibits. (Transcript, 2,712 pp.)
June 19, 1961: Briefs filed.
July 17, 1963: Examiner's Report served.

October 25, 1963: Exceptions filed to Examiner's Report.
November 30, 1963: Replies to Exceptions filed.
February 18, 1964: Oral Agrument before Commission.
February 3, 1965: ICC Report and Order on Further Hearing (325 ICC 1 to become effective April 20, 1965).
April 1, 1965: Petition of Norfolk Southern for Special Divisions.
April 28, 1965: Reply of Eastern Roads consenting to Special Divisions for Norfolk Southern.
May 18, 1965: Supplemental Report and Order of ICC (325 ICC 449).

COURT REVIEW OF ICC ORDER OF FEBRUARY 3, 1965

March 3, 1965: Complaint of Southern lines to enjoin ICC Order filed in U.S. District Court at New Orleans.
April 12, 1965: Temporary Restraining Order granted.
May 27, 1965: Hearing before District Court on Interlocutory Injunction.
June 3, 1965: Order of Court denying Interlocutory Injunction on conditions and vacating temporary restraining order leaving ICC order effective as of April 20, 1965.
March 29, 1966: Pretrial Order of Court.
May 15, 1966: Plaintiffs Briefs filed.
August 1, 1966: Defendants Briefs filed.
September 1, 1966: Plaintiffs Reply Briefs filed.
July 5, 1967: Opinion of District Court—*Aberdeen & Rockfish* v. *U.S.*, 270 F. Supp. 695.
August 8, 1967: Final Decree of District Court Setting ICC Order aside and Remanding to ICC.
August 8, 1967: Order Staying Decree.
October 2, 1967: Notice of Appeal to Supreme Court by B&O et al.
October 23, 1967: Notice of Appeal of U.S.—ICC.

IN U.S. SUPREME COURT

December 18, 1967: Jurisdictional Statement of Appellants B&O R. Co. et al.
December 21, 1967: Jurisdictional Statement of ICC filed.
January 1968: Motions of Southern Lines et al. to Affirm.
February 1968: Appellants Brief Opposing Motions to Affirm.
June 12, 1968: Appellants Brief filed (B&O et al.).
July 1968: Appellees Briefs filed.
September 1968: Appellants' Reply Brief filed.
November 12, 1968: Opinion of Supreme Court (*B&O R. Co.* v. *Aberdeen & R.R.*, 393 U.S. 87) modifying District Court Order in part and affirming as modified.
March 3, 1969: Order denying Rehearing.

RETURN TO U.S. DISTRICT COURT—FOLLOWING SUPREME COURT ACTION

March 3, 1969: Motion of Defendant Railroads for Holding Case in Abeyance pending ICC Findings required by Supreme Court.
March 11, 1969: Plaintiffs Motion for Dissolving Stay, Modifying Final Decree, and Enforcing Protective Conditions.
April 10, 1969: Northern Lines' Brief Opposing Plaintiffs' Motion.
April 24, 1969: Opinion and Order of District Court (301 F. Supp. 889) Dissolving Stay, Modifying Final Decree, and Enforcing Protective Conditions (and remanding to ICC for further hearings) and requiring resettlement of accounts within 90 days.
July 23, 1969: Joint Motion of Plaintiffs and Northern Defendants for Entry of Orders which authorize compliance with resettlement order of Court as provided in *Stipulation* of this date.
August 21, 1969: Order of Court approving resettlement plan of Stipulation as compliance with its Order of April 24, 1969. [Pursuant to this Stipulation and Order, Northern lines paid Southern lines some $33 million.]
March 17, 1970: Notice by Plaintiff Southern Roads of payments received under Stipulation of July 23, 1969.

ICC PROCEEDINGS FOLLOWING SUPREME COURT OPINION

March 4, 1969: Northern Lines Petition for Issuance of Report with Findings Required by Supreme Court filed (Dated March 3, 1969).
May 20, 1969: Reply of Southern Roads to Northern Lines' Petition dated March 3, 1969.
June 6, 1969: Northern Lines' Rebuttal Statement with Petition for Leave to File.
June 25, 1969: Southern Lines' Reply to Northern Lines' Petition for Leave to File.
April 21, 1970: ICC Report and Order, 337 ICC 74, fixing new divisional basis (and giving Northern lines about 86% of 1965 prescribed divisions).
June 11, 1970: Petition for Reconsideration filed by all parties.
July 1, 1970: Replies filed to Petition for Reconsideration.
September 11, 1970: Order of ICC denying reconsideration and fixing effective date as November 1, 1970.

FURTHER PROCEDURE BEFORE DISTRICT COURT

October 8, 1970: Plaintiff Southern Roads' Motion to Set Aside ICC Order of April 21, 1970 and for Temporary Restraining Order.
October 21, 1970: Northern Defendants' Answer & Opposing Plaintiffs' Motion—also Memo by ICC and Memo by U.S. confessing error.
October 26, 1970: Hearing before District Court.
October 29, 1970: Order of District Court Setting Aside ICC Order of April 21, 1970 and remanding to ICC for further proceedings.
November 12, 1970: Plaintiffs' Memo Opposing Limited Hearings.
December 16, 1970: Order of District Court Limiting further Hearings.
December 28, 1970: Motion of Southern Governors for New Trial, etc.
January 4, 1971: Reply of Northern Lines to Motion of Southern Governors.
January 7, 1971: Memo of U.S.-ICC Opposing Motion of Southern Governors.
January 7, 1971: Order of Court Denying Motion.
March 8, 1971: Notices of Appeal by Southern Lines and Southern Governors from District Court Order of December 16, 1970.

ICC PROCEEDINGS ON SECOND REMAND

February 11, 1971: ICC Order reopening No. 29885 for further evidentiary hearings limited to matters specified in District Court remand order of December 16, 1970, and requiring parties to submit verified statements of evidence considered necessary to comply with Court's remand.
March 23, 1971: Northern Lines' Verified Statements filed.
March 25, 1971: Verified Statements of Southern Lines and Southern Governors filed.
April 12, 1971: Replies to Verified Statements filed—Also Petition of Southern Governors to Terminate Proceedings.
Followed by Southern Lines Reply to Motion to Terminate.
Motion of Northern Lines to Strike said Reply.
August 10, 1971: ICC Order Dismissing Investigation in No. 29885 without prejudice to filing new complaints based upon current evidence.

SOUTHERN APPEALS IN THE SUPREME COURT

May 6, 1971: Jurisdictional Statements filed by Southern roads and Southern Governors et al.
June 8, 1971: Motion of Northern roads to Affirm.
July 1971: Motion of U.S.-ICC to Affirm.
July 1971: Replies of Appellants to Motions to Affirm.
September 1971: Joint Memorandum of Appellants Suggesting Mootness.
October 1971: Memorandum from U.S.-ICC re Mootness.
October 12, 1971: Order of Supreme Court vacating judgment of District Court (of December 16, 1970) and remanding to that Court with directions to dismiss proceedings as moot insofar as they fix terms of remand to ICC.

TIME REQUIRED

1. From ICC Order Reopening for Further Hearing to Effective Date of its Order of February 3, 1965 in 325 ICC 1: 6 years.
2. For Judicial Review from filing Action before District Court through Appeal to Supreme Court and back to District Court until its remand to ICC : 4 years, 2 months.
3. For ICC Handling on Remand to Effective Date of New Order: 1 year 6 months.
4. For District Court Review of New Order of ICC to denial of Motion of Southern Governors for New Trial: 3 months.
5. For ICC Proceeding on Second Remand to Dismissal of Proceedings: 6 months.
6. For Southern Appeals from District Court Order of December 16, 1970, to Vacation account of Mootness: 7 months.
7. *TOTAL* time from ICC Reopening of No. 29885 for Further Hearing to its Order Dismissing Proceeding Without Prejudice: 12 years.

ICC NO. 31503 ET AL.—TRANSCONTINENTAL DIVISIONS

April 5, 1954: Complaint filed by Eastern lines.
June 3, 1954: Complaint of MW lines filed as Sub. No. 1. (Also other subnumbered Complaints and cross-complaints).
April 26, 1955, to December 11, 1959: Hearings on intermittent schedule, mostly for cross-examination on Verified Statements. (Transcript 11,242 pages.)
June 13, 1960: Briefs filed.
December 6, 1960: Proposed Report of Examiners.
April 3, 1961: Exceptions to Proposed Report.
May 26, 1961: Replies to Exceptions.
June 20, 1961: Argument and Submission.

March 21, 1963: Report and Order of ICC—321 ICC 17—Order to become effective July 1, 1963. [*See below for Court Action to Enjoin ICC Order*]
July 26, 1963: Petitions of M-P lines et al. for Reconsideration.
September 11, 1963: Reply of Eastern Roads to Petitions for Reconsideration.
December 31, 1963: Supp. Report and Order, 322 ICC 491.

BEFORE DISTRICT COURT

June 25, 1963: Complaint of M-P Lines filed in District Court at Los Angeles (No. 63–745 EC) to set aside ICC Order.
June 27, 1963: Temporary Restraining Order of 3/21/63.
July 11, 1963: Hearing on Interlocutory Injunction.
August 3, 1963: Interlocutory Injunction Ordered.
March 11, 1964: Supplemental Complaint to Set Aside ICC order of 12/31/63.
March 24, 1964: Interlocutory Injunction ordered on ICC order of 12/31/63.
April 20, 1964: Plaintiffs' Brief filed.
June 22, 1964: Eastern Roads' Brief filed.
August 10, 1964: Plaintiff's Reply Brief filed.
January 25, 1965: Opinion District Court, 238 F. Supp. 528 Setting Aside.
February 18, 1965: Judgment and Order Staying Judgment.

BEFORE SUPREME COURT

March 15, 1965: Notice of Appeal of B&O et al.
April 16, 1965: U.S.-ICC Notice of Appeal.
May 14, 1965; Jurisdictional Statement filed by Eastern Roads.
May 1965: Jurisdictional Statement of C&NW et al.
September 15, 1965: U.S.-ICC Jurisdiction Statement. [At this stage Eastern and Transcontinental Lines entered into Agreement of September 29, 1965, as result of which following action was taken before the ICC]:
October 20, 1965: Mountain-Pacific and Eastern Lines jointly petitioned ICC to vacate its order in No. 31503 prescribing divisions covered by agreement.
January 7, 1966: ICC granted petition and vacated its order with exceptions. At this stage the further procedure in the Supreme Court was as follows:
February 15, 1966: Motions to Affirm filed by appellees on appeals.
February 15, 1966: Memo. suggesting Mootness.
March 4, 1966: Briefs of C&NW Opposing Motion to Affirm.
March 1966: Memo for U.S.-ICC re Mootness and Opposing Motion to Affirm.
April 4, 1966: Supreme Court in Eastern appeal vacated Judgment and remanded with instructions to dismiss case as moot.
April 4, 1966: Supreme Court noted Jurisdiction in C&NW and U.S. Appeals.
April 19, 1967: Appeals Argued before Supreme Court.
May 29, 1967: Opinion Supreme Court, 387 U.S. 326 sustaining ICC orders prescribing divisions as between Midwestern and M–P lines.

TIME REQUIRED

1. From filing of Eastern Complaint to Initial Report of ICC: About 9 years.
2. From Court Action to Enjoin to Order of District Court: About 1 year, 8 months.
3. From Appeal to Supreme Court to Dismissal of Case as Moot (account Settlement): About 1 year.
4. *TOTAL* for Litigation from filing Complaint with ICC to Supreme Court Dismissal as Moot: 12 years.

Source: Penn Central.

APPENDIX D

EXHIBIT 1

JULY 28, 1960.

Confidential

MR. DAVID C. BEVAN,
Financial Vice President, The Pennsylvania Railroad Co.
Philadelphia, Pa.

DEAR DAVE: The Committee of Potential Pipelines in the Pennsylvania Railroad system has discussed in the past various proposals all of which proposals have been items which were small, and in most cases, independent promotions.

With the exception of a proposal discussed on the 26th of July, these proposals have not been worthy of favorable recommendation.

This memorandum has a two-fold purpose; (1) to recommend a basic approach to pipelining in the Pennsylvania Railroad system, and (2) a specific recommendation for an acquisition.

We believe the approach to the pipeline situation in the Pennsylvania should be one of a positive nature wherein the Railroad system, with premeditation, will cause a pipeline management unit to be contained within the Pennsylvania Railroad system. The purpose of this unit will be to acquire and/or construct pipeline systems within the area covered by the Pennsylvania Railroad and its subsidiaries and/or area covered by any possible future consolidations.

The point mentioned in the previous paragraph is vitally important because it activates, in a practical manner, that which up to this point has been a passive type of Committee action. This nucleus of pipeline management will have as its objective the creation of the maximum pipeline transportation system within the confines of the area served and perhaps at a later date, to spill over to adjacent areas. This will attempt not only to profit by pipelining transportation within its areas but to recapture transportation income which has been lost to the Railroad through changes in methods of transportation.

The specific recommendation made herein is for Pennsylvania Railroad to acquire the Buckeye Pipe Line Company. The Buckeye Pipe Line Company is a common carrier line. There is no known stock control of the Buckeye Pipe Line. The Buckeye Pipe Line Company will fit in and dovetail with the Pennsylvania Railroad system as is now constituted.

The Buckeye Pipe Line Company is a going concern having a gross income for the year 1959 of $22,600,000; a net income of $3,400,000 and a cash flow of approximately $6,200,000, earnings of $2.62 per share with dividends in 1959 at $1.45 a share.

The recent quote on the New York Stock Exchange was 31–31½.

There are issued and outstanding 1,310,672 shares of Buckeye Pipe Line Company Common Stock of no par value. The total debt of the Pipe Line at the end of 1959 was $23,200,000. Cash and equivalent at the end of 1959 amounted to approximately $3,500,000.

The acquisition of the Buckeye Pipe Line Company would provide the Pennsylvania Railroad and its system with: (a) a management team for pipelining; (b) a basic system for covering their area and a system which could be expanded in the Pennsylvania Railroad area; (c) It is believed that this acquisition would allow constructive planning to be made with a view to the erection of more industrial properties on the Pennsylvania system which we are sure is a goal of the management of the Pennsylvania; (d) The probabilities are that savings will be made to the Pennsylvania Railroad's fuel cost; (e) In all probability, would allow the Pennsylvania Railroad to serve industry, including the public utility industry with fuel and standby fuel in the form of propane. We believe this to be important as our approach is that the Railroad is in the transportation business and they should take part in transporting, in a modern way, portions of the fuel now needed and that which will be needed in the future; (f) Inasmuch as this is a going company, the Pennsylvania system will not be putting out money on a promotional basis, but will have a return on its money from the very moment it commences acquisition; (g) Under the tax laws, it is probable that the net income of $3,436,000 will be substantially increased due to the tax haven that may be provided by the Pennsylvania Railroad system.

We have taken the liberty of discussing this matter with a large institutional investor; namely, the Northwestern Mutual Life Insurance Company, which company, in addition to owning debt of the Buckeye Pipe Line Company, owns 103,000 shares of the Common Stock. The Financial Vice President of the Northwestern Mutual Life Insurance Company, Mr. Peter B. Langmuir, agrees with us that there is an opportunity here for the Railroad to commence the building of a substantial pipeline empire under the guidance and ownership of the Pennsylvania Railroad system. Mr. Langmuir has told us that he will cooperate with us.

The method of acquisition, in our opinion, would be: (a) an understanding with the Northwestern Mutual Life Insurance Company, which means that the Pennsylvania at

this point would not have to buy the 103,000 shares of Common Stock, but could accept a partnership type of operation with the Northwestern with the view to building a bigger pipeline system; (b) a gradual and confidential market acquisition of the Buckeye stock, together with the purchase of any blocks which may become available would be the second step. This amount of stock to be acquired in the open market should probably be in the neighborhood of 250,000 shares to 350,000 shares which, along with the 103,000 of Northwestern, would assure working control; (c) the third step would probably be an offer to stockholders to tender for cash or for stock additional shares of Buckeye. Depending on the desire of the Pennsylvania management, additional tenders or additional cash acquisitions of the stock could be made until the Pennsylvania Railroad System had acquired 80% or higher, at which time they would consolidate.

When, as and if acquisition or control has been established, it is our belief that there will be numerous opportunities to extend the present Buckeye operation.

The question as to whether the commencement of the acquisition should be discussed with the present management of Buckeye or whether acquisition should be commenced without discussion is a matter of managerial decision.

The management of the Buckeye Pipe Line Company headed by Mr. George Patterson is believed to fall in the category of very satisfactory, not excellent. The depth and operational capacity of the management is sound; the only real question being as to whether or not the President is strong enough or dynamic enough to proceed with strong purpose for the creation of the pipeline system which is envisioned here. He may be, but a careful analysis of his potential should be conducted. If he is not, in the opinion of your management, we can assure you that there are available personnel who could fulfill the function of strong, energetic and far-seeing management.

This memorandum must be considered extremely confidential. Copies of the latest Annual Report of the Buckeye Pipe Line Company are attached hereto. In addition to the Annual Report, a proxy statement dated March 31, 1960 is also attached.

Respectfully submitted,

CHARLES J. HODGE.

EXHIBIT 2

[From the Baltimore Sun, May 14, 1968]

PENN CENTRAL WILL DIVERSIFY—TO SPEND $500,000,000 IN VARIETY OF FIELDS

PHILADELPHIA, May 14 (A.P.)—The Penn Central Company plans to diversify by spending about $500,000,000 in a variety of fields in the next six years, according to chairman Stuart T. Saunders.

Saunders, speaking Monday at a meeting of business and financial leaders, said the money to diversify would come from the disposition of 1,700,000 shares of Norfolk & Western stock and "other sources."

"We expect to replace these assets with sound investments that will become additional sources of growth and stability of earnings," Saunders said. "We are continuing to seek companies with imaginative management with the promise of expanding profits."

Saunders said, however, diversification would not come "at the expense of our transportation business.

"We are totally committed to our responsibilities as a common carrier and we are convinced that we can make our railroad operations stand on their feet."

EXHIBIT 3

[From the Philadelphia *Bulletin*, November 7, 1963]

PENNSY EYES DIVERSIFICATION, SAUNDERS SAYS

NEW YORK.—Stuart T. Saunders, board chairman of Pennsylvania Railroad, reports the road is actively considering a variety of diversification proposals.

In his first news conference since becoming the Pennsylvania chief executive officer five weeks ago, Saunders outlined plans for giving the nation's largest railroad "a new look."

He said railroad operations, in the red in 1962, will yield a profit in 1963.

Saunders refused to be drawn out on what sort of diversification ideas were being explored, saying they were embryonic. He indicated some of them might lie outside transportation.

EXHIBIT 4

[Memoranda dated May 10, 1963, from P.R.R. Finance Department]

Through a combination of forces with which we are too familiar, competing modes of transportation have cut deeply into railroad traffic, thus imparing the earning capacity of many railroads. The current pattern of railroad mergers reflects the fact that in certain areas the railroads are overbuilt in relation to present and anticipated traffic potential. To some degree at least, railroad managements are confronted with the alternatives of operating within the present scope on the most economic basis attainable, or of using capital

reserves and credit to diversify into other industries of greater profitability or indicated growth potential. Logically, diversification should be into an industry which supplements or complements the basic operation, and one which in concept and philosophy is readily understood by the management of the parent company. By any approach to the question, pipe lines appear to offer a most promising avenue for diversification by railroads and in conjunction with our forward planning, on the recommendation of the Financial Department for the past few years we have utilized the services of a firm of consultants, Pipe Line Technologists, Inc., of Houston, Texas, to assist us in exploring the possibilities of pipe lines, including how best to utilize our right of way for this purpose.

Merger developments in the East point to the ultimate divestment of our interest in the Norfolk & Western and we have publicly annouuced and have gone on record with the Iterstate Commerce Commission that, upon consummation of the P.R.R.–N.Y.C. merger proposal, we were prepared to dispose of our entire holdings over a period of time in an orderly manner.

With N. & W. Common now selling around 118, our present holding of N. & W. stock have a market value of approximately $290 million and our option to exchange our Wabash Common for N. & W. Common at any time after the sixth year of the lease of the Wabash would add close to $80 million to this value at current prices. About 70% of our present holdings are currently pledged to secure Pennsylvania Company debt.

At 1962 levels, our N. & W. holdings provide annual income of almost $13.5 million and the stock which we would receive in connection with the Wabash transaction would increase this annual income to almost $17 million. Although this dividend income is not now subject to any Federal income tax because of our current lack of taxable earnings, it is important to remember that a substantial difference exists tax-wise between dividend income and other types of income.

From this brief review of our holding of N. & W. stock, it can be seen that its liquidation poses some difficult problems and it may well be that we will be allowed less time to liquidate than we believe is desirable.

Considering the two factors—divestment of our interest in the N. & W. and diversification into pipe line transportation—time would be conserved and industry status more quickly attained by acquiring a strong position in a well-known and firmly established pipe line company, preferably in the territory served by the Pennsylvania. Our studies lead us to believe Buckeye Pipe Line Company is best suited to our objectives. The Buckeye system and the areas served are shown on the attached map, market Exhibit **A**.

Specifically, the apparent advantages of Buckeye may be summarized as follows:

(1) Buckeye is strategically located in the industrial heart of the nation where a normal but continuous rate of growth may be reasonably expected.

(2) The Company has a long history of acceptance by shippers, consignees and connecting carriers.

(3) The territory served by Buckeye generally conforms with the service areas of the P.R.R. and New York Central.

(4) Buckeye is an important crude oil carrier to oil refineries in Michigan, Ohio, western Pennsylvania and western New York.

(5) In recent years, 1953 to date, Buckeye has directed its major expansion efforts to the movement of refined products, including motor fuels, aviation fuels, burning oils and LPG's, the latter having excellent growth potential. Presently, Buckeye has basic coverage in the states of Indiana, Michigan, Ohio, Pennsylvania, New York and New Jersey.

(6) Buckeye is a relatively large pipe line carrier in terms of transportation area, tonnage, and scope of services. It is unlikely that, at the present level of economic development, any part of the United States could support a new carrier system comparable with Buckeye.

(7) Buckeye's operations over the past several years reflect experienced and capable management. Unfortunately, earlier management was neither alert nor aggressive, allowing competition to establish strong positions, particularly in product transportation. Indications are that present management is gradually overcoming inherited handicaps.

(8) With our extensive right-of-way, the acquisition of an old established company would provide an excellent springboard for further penetration into the pipe line transportation industry.

At the current price and based on the regular quarterly dividend of $1.25 per share, N. & W. Common is selling on about a 4¼% basis, or 4.65% based on the total dividends of $5.50 per share paid in 1962. At the present quarterly rate of 50¢ per share, Buckeye stock is selling at slightly over a 3% basis. Aside from the growth pattern reflected in Buckeye's volume and earnings, there are two areas in which control by Pennsylvania could act to increase Buckeye's earnings and dividends.

The first stems from the possible utilization of Pennsylvania system tax losses in the future through acquisition of 80% or more of the Buckeye stock. (At the present market, all of Buckeye's outstanding stock has a value of approximately $87 million.) In the past five years, Buckeye incurred Federal income taxes averaging $3.08 per share per year; in the past three years, the average was $3.27 per share; and in 1962, such taxes amounted to $3.46 per share. These amounts are indicative of the potential increased income available to a parent company with a tax situation similar to ours. We would have to be unduly pessimistic with respect to the benefits to be derived from our merger

with the New York Central if we were to assume we could remain indefinitely in a tax loss position. However, it is a fact that we have accumulated a large carry-forward loss and none of our system companies have paid Federal income taxes subsequent to 1953. Prior to that time, our effective rate generally was substantially below the indicated rate. Furthermore, in the more recent years we have not claimed all permissible deductions and, thus, there are options available to us with respect to additional deductions which we can exercise when our earnings position so warrants. Therefore, it seems apparent that a considerable portion of the tax liability of Buckeye could be avoided through acquisition of at least 80% of its stock by Pennsylvania with a corresponding increase in the earnings available to Pennsylvania.

The second area of potential increased earnings to Buckeye involves the pipe line movement of diesel fuel to railroad fueling points contiguous to the pipe line system. An accurate evaluation of benefits in this area would necessitate a study in considerable detail; however, some general conclusions can be drawn from information at hand, including Interstate Commerce Commission reports and Buckeye tariffs.

The routes of a number of Buckeye's lines follow generally the patterns of the Pennsylvania and New York Central systems. Buckeye publishes rates to Altoona, Pittsburgh, Terre Haute, Indianapolis and Columbus. In addition, deliveries are made at Inglehook (about 15 miles north of Harrisburg) and Enola. The pipe line crosses the Pennsylvania main line at Freeport, about 20 miles north of Pitcairn. Through interconnection with the Atlantic Pipe Line system, deliveries are made in the Buffalo area to Tonawanda. Short laterals to railroad fuel stations at these and other points would permit direct deliveries of diesel fuel to existing storage tanks. This type of operation would probably decrease the costs and losses associated with loading, handling and unloading tank cars of diesel fuel; however, if there are benefits in this area so far as railroad operating costs are concerned, it would seem to follow that they are available to us without regard to our acquiring an interest in Buckeye and, therefore, this phase should not have any significant bearing on the matter of acquiring an interest.

Fundamentally, the majority of costs associated with the operation of pipe lines are fixed. Incremental throughput volume on a pipe line, up to the capacity of the installed facilities, requires principally only additional fuel or electric power for pumping equipment. Thus, if we measure expenses on an incremental basis, we have a basis to judge the optimum results to Buckeye of moving diesel fuel over their system. To measure minimum results, we can assume that some new construction would be necessary and that the associated expenses are equal to the system-wide average, including depreciation, state and local taxes, interest, and other fixed charges for trunk line movements over the Buckeye system.

Present daily consumption of P.R.R. is about 15,600 barrels a day and New York Central 15,100 barrels. A review by our fuel purchasing people indicates that in all probability, the maximum daily potential for pipe line delivery of the P.R.R. and N.Y.C. as now constituted would be about 17,000 barrels per day. In the case of P.R.R., this would involve only a change in the method of bulk deliveries. For the N.Y.C., it would mean a substitution of bulk for tank car or truck deliveries.

Every railroad operating in the Buckeye area is a source of potential traffic. No doubt some railroads are now using Buckeye and other lines in the area for some of their fuel requirements but no information is available on the extent to which this traffic potential has been developed.

Exhibit B reflects the additional earnings which might be expected at various levels if diesel fuel movements based on system-wide average expenses of Buckeye, as mentioned previously, while Exhibit B–1 reflects the additional earnings which might be expected at similar levels of diesel fuel movements based on incremental expenses. Such expenses are assumed to equal one-half of average system-wide trunk line costs for such items as pipe line operating and maintenance expenses, general office salaries and some miscellaneous costs. Depreciation, state and local taxes, interest and other fixed charges have been eliminated.

Summarized, these exhibits show potential additional earnings from the transportation of diesel fuel, as follows:

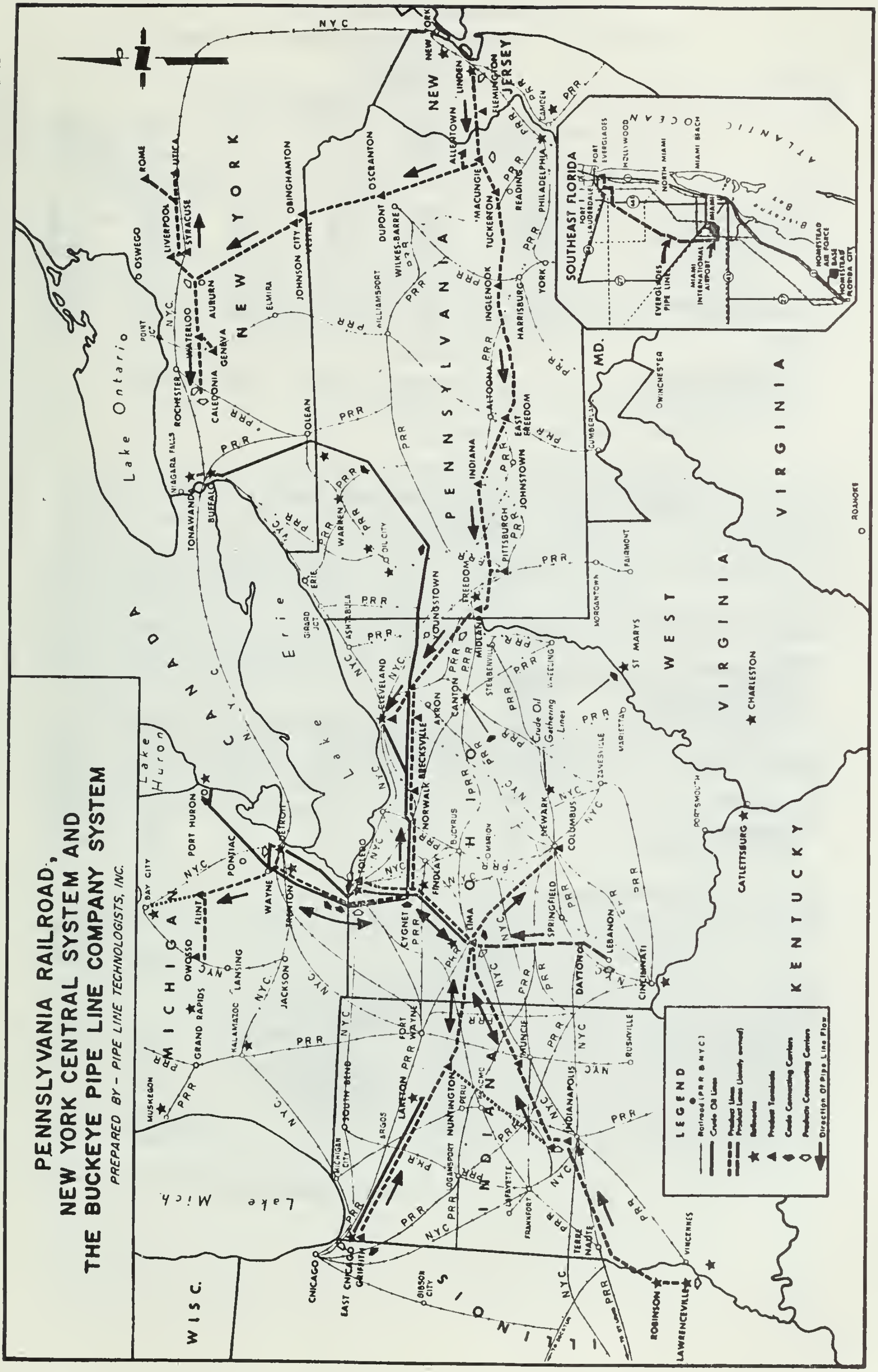
EARNINGS PER SHARE

Barrels per day	Average cost basis		Incremental cost basis	
	Before Federal income tax	After Federal income tax	Before Federal income tax	After Federal income tax
5,000	$0.10	$0.05	$0.19	$0.09
10,000	.19	.09	.39	.19
15,000	.29	.14	.58	.28
20,000	.39	.19	.78	.37
25,000	.48	.23	.97	.47

A general review of the Buckeye Pipe Line Co., including some pertinent figures on their financial results over the past ten years is attached as Exhibit C.

Financial Department, May 10, 1963.

EXHIBIT A



C-280-1559

EXHIBIT B

BUCKEYE PIPE LINE CO.—EFFECT OF ADDITIONAL RAILROAD DIESEL FUEL VOLUME

[Based on average costs]

	Buckeye, 1962	Additional barrels per day— 5,000	10,000	15,000	20,000	25,000
Revenue	27,393,000	310,000	621,000	931,000	1,241,000	1,551,000
Expenses:						
Operating expenses	11,313,000	105,000	210,000	314,000	419,000	523,000
Depreciation	4,085,000	43,000	87,000	131,000	174,000	218,000
Interest and other charges	1,378,000	15,000	30,000	45,000	60,000	75,000
State and local taxes	1,742,000	18,000	36,000	55,000	73,000	91,000
Total expenses	18,518,000	181,000	363,000	545,000	726,000	907,000
Income before income taxes	8,875,000	129,000	258,000	386,000	515,000	644,000
Federal income taxes	4,604,000	67,000	134,000	201,000	268,000	335,000
Net income	4,271,000	62,000	124,000	185,000	247,000	309,000
Net income per share: [1]						
Before Federal income taxes	$6.67	$0.10	$0.19	$0.29	$0.39	$0.48
After Federal income taxes	3.21	.05	.09	.14	.19	.23

[1] Based on 1,331,057 shares outstanding, December 31, 1962.

EXHIBIT B-1

BUCKEYE PIPE LINE CO.—EFFECT OF ADDITIONAL RAILROAD DIESEL FUEL VOLUME

[Based on incremental costs]

	Buckeye, 1962	Additional barrels per day— 5,000	10,000	15,000	20,000	25,000
Revenue	$27,393,000	$310,000	$621,000	$931,000	$1,241,000	$1,551,000
Expenses:						
Operating expenses	11,313,000	52,000	105,000	157,000	210,000	262,000
Depreciation	4,085,000					
Interest and other charges	1,378,000					
State and local taxes	1,742,000					
Total expenses	18,518,000	52,000	105,000	157,000	210,000	262,000
Income before income taxes	8,875,000	258,000	516,000	773,000	1,031,000	1,289,000
Federal income taxes	4,604,000	134,000	268,000	402,000	536,000	670,000
Net income	4,271,000	124,000	248,000	371,000	495,000	619,000
Net income per share: [1]						
Before Federal income taxes	$6.67	$0.19	$0.39	$0.58	$0.78	$0.97
After Federal income taxes	3.21	0.09	0.19	0.28	0.37	0.47

[1] Based on 1,331,057 shares outstanding, Dec. 31, 1962.

	Estimated earnings per barrel (cents)
Revenue	17.000
Expenses:	
Operating expenses	5.735
Depreciation	2.389
Interest and other charges	.820
State and local taxes	.998
Total expenses	9.942
Income before income taxes	7.058
Federal income taxes	3.670
Net income	3.388

	Mileage	Pipeline rate (cents per barrel)
Selected railroad diesel fuel movements:		
Linden, N.J., to:		
Inglehook (Harrisburg), Pa	169	15
Pittsburgh, Pa	347	24
Lawrenceville, Ill, to:		
Indianapolis, Ind	124	12
Detroit, Mich., to:		
Columbus, Ohio	204	18
Average	211	17

Note: The above tabulation represents an arithmetical average rather than a weighted average.

[EXHIBIT B-1—continued]

	Estimated earnings per barrel (cents)
Revenue	17,000
Expenses:	
Operating expenses	2,868
Depreciation	
Interest and other charges	
State and local taxes	
Total expenses	2,868
Income before income taxes	14,132
Federal income taxes	7,349
Net income	6,783

	Mileage	Pipeline rate (cents per barrel)
Selected railroad diesel fuel movements:		
Linden, N.J., to:		
Inglehook (Harrisburg) Pa	169	14
Lawrenceville, Ill., to:		
Indianapolis, Ind	124	12
Detroit, Mich., to:		
Columbus, Ohio	204	18
Average	211	17

Note: The above tabulation represents an arithmetical average rather than a weighted average.

EXHIBIT C

Buckeye Pipe Line Co.—General Review of Operations and Financial Results 1953–62, Inclusive

HISTORY

The Company was incorporated in Ohio in 1886 and was originally controlled by Standard Oil Company (N.J.). In 1911, with the dissolution of the Standard Oil Trust, the stock of Buckeye was distributed to Standard Oil stockholders and Buckeye was then operated under common management with three other Standard Oil throw-offs—Indiana Pipe Line Co., Northern Pipe Line Co. and New York Transit Co., Inc. (a pipe line). In 1943, Indiana Pipe Line was merged into Buckeye and the other two companies became wholly-owned subsidiaries. Buckeye has two other affiliates, neither of which has thus far made any significant contribution to earnings:

(a) Everglades Pipe Line Co. (41% interest with Cities Service Co. the other principal owner) which owns a pipe line completed in 1959, running from Port Everglades, Fla., to Miami International Airport.

(b) Buckeye Tank Terminals Co. (joint ownership with Chicago Bridge & Iron Co.) which was organized in 1958 to construct, own and operate fuel terminals and related facilities.

Late in 1960, Buckeye purchased Esso's Tuscarora Pipe Line running from Allentown, Pa., to Midland, Pa., which is near the Pennsylvania-Ohio line, about 10 miles west of Conway, Pa. This purchase enabled Buckeye to link together its Eastern and Mid-West products systems. Another important expansion move was made in 1961 through a joint undertaking with Texas Eastern Transmission Corp. involving the construction of a 96-mile products line from Lebanon, O. to Lima, O. This link with Texas Eastern has enabled Buckeye to move into the growing and profitable area of liquified petroleum gas transportation.

OPERATIONS

Although originally a crude oil gathering system, Buckeye has directed its major expansion efforts in recent years toward the movement of refined products and in 1962 more than 40% of its volume as measured by barrel miles was represented by products movements. Table I shows how Buckeye's crude movements have tended to stabilize in recent years and it also illustrates the tremendous growth in products movements.

Basically, Buckeye is a common carrier operating a 7,500 mile system in seven states (Illinois, Michigan, Indiana, Ohio, Pennsylvania, New York and New Jersey) generally corresponding to the geographical area served by the Pennsylvania and New York Central railroads. It is an important crude oil carrier to oil refineries in Michigan, Ohio, western Pennsylvania and western New York. It publishes local rates and publishes or participates in joint rates for the transportation of petroleum products in two areas. In the East, the movement is generally west and north from Linden, Newark, Paulsboro, N.J., to Pennsylvania, New York and to Cleveland, O. In the Mid-West, the system operates around a hub at Lima, O., handling products in all directions between points in Illinois, Indiana, Ohio and Michigan.

TABLE I.—BUCKEYE PIPE LINE CO., DAILY AVERAGE DELIVERIES

[Thousands of barrels]

Year	Crude	Products	Total	Year	Crude	Products	Total
1953	437	55	492	1958	411	165	576
1954	421	104	525	1959	449	182	631
1955	446	119	565	1960	434	200	634
1956	486	153	639	1961	431	217	648
1957	454	158	612	1962	443	235	678

STOCK

As of December 31, 1962, there were 1,331,057 shares of stock outstanding and held by 5,544 stockholders, with 2,000,000 shares authorized. However, on May 1, stockholders, approved a proposal to increase the authorized shares to 4,000,000 to effect a 2 for 1 stock split. The stock has been listed on the New York Stock Exchange since June 25, 1956. The price range for the years 1958 to date is shown below with current sales running near the 1963 high.

Year	High	Low
1958	30	22½
1959	33¾	28¼
1960	38⅞	28
1961	59	35
1962	61½	45¼
1963	67¼	57

Month-by-month prices and number of shares traded on the New York Stock Exchange from January 1962 through March 1963 are listed in Table II.

At the close of 1962, about 2% of the Company's stock was held by the trustees of the Company's Thrift Plan.

In 1959, the shareholders approved a restricted stock option plan involving 75,000 shares of stock. At the close of 1962, options involving 20,385 shares had been exercised, 2,250 shares were reserved for issuance under the plan, and options to purchase 52,365 shares were outstanding, of which 9,015 shares were exercisable.

TABLE II.—BUCKEYE PIPE LINE CO. PRICE RANGE AND NUMBER OF SHARES TRADED ON NEW YORK STOCK EXCHANGE (BY MONTHS)

Month	1962			1963		
	High	Low	Number of shares	High	Low	Number of shares
January	61½	55⅜	18,800	59	57	86,300
February	60¾	58½	7,200	61	58	12,200
March	60½	59	8,100	62	58½	8,700
April	60¼	55½	27,600			
May	58	47¾	17,600			
June	50	45¼	7,600			
July	48	46½	6,100			
August	51½	46¼	23,000			
September	55	51¾	5,700			
October	52½	49⅛	7,600			
November	55½	51½	6,500			
December	58⅛	55½	22,200			
Total			158,000			

EARNINGS

Buckeye has directed its major expansion efforts in recent years toward the movement of refined products and, as a result, the company's growth in sales and earnings has been impressive. Furthermore, in the face of generally declining profit margins elsewhere, it has been able to show a modest but generally constant improvement in its profit margin. In 1952, the company reported sales of $12.4 million and net income of $1.6 million, equivalent to 13.2% of sales. By 1962, sales had increased to $27.4 million with net income of $4.3 million being equivalent to 15.7% of sales. Table III–A shows the sales and net income, before and after Federal income taxes, for the ten-year period 1953 to 1962, inclusive, as well as the relationship of earnings to sales and to shareholders' equity. Table III–B presents these same figures in the form of three-year moving averages. Per share earnings, before and after Federal income taxes, for the ten-year period are shown in Table III–C while the cash throw-off, in the aggregate and on a per share basis, is covered in Table III–D.

TABLE III-A.—BUCKEYE PIPE LINE CO., SALES, EARNINGS, AND SHAREHOLDERS' EQUITY AND RELATIONSHIP OF EARNINGS TO SALES AND SHAREHOLDERS' EQUITY 1953-62, INCLUSIVE

[In millions of dollars]

		Net income			Net income before Federal income tax		Net income after Federal income tax	
	Sales	Before Federal income tax	After Federal income tax	Share-holders' equity [1]	As percent of sales	As percent of share-holders' equity	As percent of sales	As percent of share-holders' equity
1953	13.1	2.8	1.5	18.4	21.37	15.22	11.45	8.15
1954	17.1	4.1	2.0	19.2	23.98	21.35	11.70	10.42
1955	19.1	4.7	2.2	20.3	24.61	23.15	11.52	10.84
1956	21.9	6.5	3.0	23.6	29.68	27.54	13.70	12.71
1957	21.9	5.6	2.7	26.8	25.57	20.90	12.33	10.07
1958	21.3	6.4	3.0	27.8	20.05	23.02	14.08	10.79
1959	22.7	7.3	3.4	29.2	32.16	25.00	14.98	11.64
1960	23.2	7.3	3.5	30.6	31.47	23.86	15.09	11.44
1961	26.5	8.5	4.0	32.2	32.08	26.40	15.09	12.00
1962	27.4	8.9	4.3	34.4	32.48	25.87	15.69	12.50

[1] Average beginning and end of year.

TABLE III-B.—BUCKEYE PIPE LINE CO., MOVING 3-YEAR AVERAGES, SALES, EARNINGS, AND SHAREHOLDERS' EQUITY AND RELATIONSHIP OF EARNINGS TO SALES AND SHAREHOLDERS' EQUITY 1953-62, INCLUSIVE

[Millions of dollars]

Period	Sales	Net income		Shareholders' equity [1]
		Before F.I.T.	After F.I.T.	
1953 to 1955	$16.4	$3.9	$1.9	$19.3
1954 to 1956	19.4	5.1	2.4	21.0
1955 to 1957	21.0	5.6	2.6	23.6
1956 to 1958	21.7	6.2	2.9	26.1
1957 to 1959	22.0	6.4	3.0	27.9
1958 to 1960	22.4	7.0	3.3	29.2
1959 to 1961	24.1	7.7	3.6	30.7
1960 to 1962	25.7	8.2	2.9	32.4

[1] Based on average beginning and end of year for each year.

Period	Net income before F.I.T.		Net income after F.I.T.	
	As percent of sales	As percent of shareholders' equity	As percent of sales	As percent of shareholders' equity
1953 to 1955	23.78	20.21	11.59	9.84
1954 to 1956	26.29	24.29	12.37	11.43
1955 to 1957	26.67	23.73	12.38	11.02
1956 to 1958	28.57	23.75	13.36	11.11
1957 to 1959	20.09	22.94	13.64	10.75
1958 to 1960	31.25	23.97	14.73	11.30
1959 to 1961	31.95	25.08	14.94	11.73
1960 to 1962	31.91	25.31	15.18	12.04

TABLE III-C.—BUCKEYE PIPE LINE CO. EARNINGS PER SHARE BEFORE AND AFTER FEDERAL INCOME TAXES, 1953-62, INCLUSIVE

Year	Net income per share		Number of shares (Dec. 31)
	Before Federal income taxes	After Federal income taxes	
1953	$2.57	$1.39	1,094,456
1954	3.78	1.80	1,094,456
1955	4.34	2.05	1,094,456
1956	4.97	2.25	[1] 1,310,672
1957	4.29	2.02	1,310,672
1958	4.87	2.26	1,310,672
1959	5.59	2.62	1,310,672
1960	5.56	2.65	1,310,672
1961	6.47	3.02	1,312,942
1962	6.67	3.21	1,331,057

[1] 216,216 shares issued as result of conversion of $4,000,000 convertible debenture bonds issued in 1953.

TABLE III-D.—BUCKEYE PIPE LINE CO.—CASH THROWOFF, 1953-62, INCLUSIVE

[In millions]

Year	Net income	Depreciation	Deferred Federal income tax	Cash throwoff	Federal income tax	Cash throwoff before Federal income tax	Number of shares	Per share: Cash throwoff	Per share: Cash throwoff before Federal income tax
1953	$1.5	$1.5	$0.2	$3.2	$1.1	$4.3	1,049,456	$2.93	$3.92
1954	2.0	2.1	.5	4.6	1.6	6.2	1,094,456	4.20	5.66
1955	2.2	2.3	.7	5.2	1.8	7.0	1,094,456	4.77	6.45
1956	3.0	2.4	.8	6.2	2.8	9.0	1,310,672	4.72	6.84
1957	2.7	2.5	.8	6.0	2.1	8.1	1,310,672	4.59	6.22
1958	3.0	2.7	.6	6.3	2.8	9.1	1,310,672	4.80	6.91
1959	3.4	2.8	.4	6.6	3.6	10.2	1,310,672	5.04	7.75
1960	3.5	3.4	.1	7.0	3.7	10.7	1,310,672	5.33	8.13
1961	4.0	4.0	.1	8.1	4.4	12.5	1,312,942	6.18	9.55
1962	4.3	4.1	.8	9.2	3.7	12.9	1,331,057	6.93	9.74

DIVIDENDS

Dividends have been paid in every year since the Company went public under the U.S. Supreme Court disintegration order in 1911. In the ten-year period 1953 to 1962, incl., the quarterly rate has been increased from 20¢ per share to 45¢ per share with the result that in each year, except 1958, the annual payments show an uninterrupted increase. In the first quarter of 1963, the rate was increased to 50¢ per share, or $2 on an annual basis. On the average, about 57% of earnings have been paid out in dividends. The dividend record over the ten-year period 1953–1962, incl., is contained in Table IV.

Certain long term debt obligations contain provisions under which earnings retained in the business are restricted at December 31, 1962, in the amount of $6,900,306. However, retained earnings on that date were close to $19 million and, from a practical standpoint, the restrictions contained in the debt instruments do not appear to present any problems so far as the Company's dividend policy is concerned.

TABLE IV.—BUCKEYE PIPE LINE CO. DIVIDENDS, 1953-62, INCLUSIVE

Year	Quarterly rate	Dividends paid: Per share	Dividends paid: Total	Net income	Dividends as percent of net income
1953	$0.20	$0.80	$875,565	$1,515,921	57.76
1954	.20-.25	.90	985,010	1,972,431	49.94
1955	.25	1.00	1,094,456	2,242,027	48.82
1956	.30	1.20	1,426,860	2,954,212	48.30
1957	.35	1.40	1,834,941	2,653,613	69.15
1958	.35	1.40	1,834,941	2,959,894	61.99
1959	.35-.40	1.45	1,900,475	3,436,181	55.31
1960	.40	1.60	2,097,075	3,473,503	60.37
1961	.40-.45	1.70	2,229,733	3,970,676	56.15
1962	.45	1.80	2,385,244	4,271,346	55.84
Averages:					
10 years—1953 to 1962		1.33	1,666,430	2,944,980	56.59
5 years—1958 to 1962		1.59	2,089,494	3,622,320	57.68
3 years—1960 to 1962		1.70	2,237,351	3,905,175	57.29

DEBT—CAPITALIZATION

At the close of 1962, the outstanding long term debt of Buckeye amounted to $35,801,000, as shown in Table V, with $2,353,000 due in 1963 and the balance of $33,-448,000 maturing, as follows:

Year:	*Annual amount*	Year:	*Annual amount*
1964–69	$2,275,000	1979–84	560,000
1970	3,873,000	1985	660,000
1971	5,943,000	1986	260,000
1972–77	693,000	1987	520,000
1978	966,000		

The relationship of debt to total capitalization during the past ten years is covered in Table V–A. As of December 31, 1962, debt represented about 50% of total capitalization.

BUCKEYE PIPE LINE CO.—LONG TERM DEBT, DEC. 31, 1962

[Includes portion due in 1 year]

Issue	Interest rate (percent)	Due	Callable	Outstanding Dec. 31, 1962
Consolidated sinking fund debentures ($30,000,000 dated Sept. 1, 1951).	3½	Sept. 1, 1971 [1]	Yes	$15,600,000
Promissory notes [2]	2.85	Serially to Dec. 1, 1970	(?)	4,300,000
Notes—1958 ($2,000,000)	4⅞	Serially to May 1, 1978	Yes	2,401,000
Notes—1960 ($7,500,000)	5¼	Serially to June 1, 1985	Yes	7,000,000
Notes—1962 ($6,500,000)	47.0	Serially to June 1, 1987	Yes	6,500,000
Total				35,801,000

[1] Annual sinking fund payments of $1,600,000 through 1963 and $1,250,000 thereafter (bonds callable at par for sinking fund purposes)
[2] $4,930,000 assumed by Buckeye on acquisition of assets of Tuscarora Pipe Line Co. in 1960.

TABLE V-A.—BUCKEYE PIPE LINE CO. RELATIONSHIP OF DEBT [1] TO TOTAL CAPITALIZATION, 1953–62, INCLUSIVE

[Dollar amounts in millions]

Year end	Debt	Shareholders' equity	Total capitalization	Debt as percent of total capitalization
1953	$33.5	$18.7	$52.2	64.2
1954	32.4	19.7	52.1	62.3
1955	30.8	20.8	51.6	59.7
1956 [2]	25.2	26.4	51.6	48.9
1957	23.6	27.2	50.8	46.5
1958	24.8	28.4	53.2	46.6
1959	23.2	29.9	53.1	43.7
1960	33.9	31.3	65.2	52.0
1961	31.9	33.1	65.0	49.0
1962	35.8	35.6	71.4	50.2

[1] Includes portion due in 1 year.
[2] $4,000,000 convertible debentures issued in 1953 converted into 216,216 shares of stock.

CAPITAL EXPENDITURES

At the close of 1952, Buckeye's investment in property, plant and equipment amounted to $51 million gross—$26.1 million net after depreciation and amortization. At the end of 1962, this investment had increased to $119 million gross—$71 million net after depreciation and amortization. As shown in Table VI, capital expenditures in this ten-year period (1953–1962, incl.) aggregated $72.2 million. While most of this money was spent in the expansion of its products division, the crude division has been upgraded. During this period, Buckeye borrowed a total of $40.5 million so that 44%, or $31.7 million, of the total capital expenditures was financed initially from internally generated funds.

EXHIBIT 5

NEW YORK CENTRAL SYSTEM,
Collinwood, Ohio, November 8, 1963.

Mr. J. O. BOISI,
Vice President, Real Estate,
New York, N.Y.

In line with our discussions of areas of diversification for the Railroad, we are enclosing a preliminary study which indicates that transmission and sale of raw water can be extremely profitable and can be accomplished with little or no land acquisition. Benefits to the Railroad include:

1. Profits from the sale of water. Actual operating statements in the report prove this profitability.

2. A distinct advantage in the attraction of industry to location on the Railroad where water is immediately available.

3. Profits to be made in sale of real estate which will appreciate in value when water is made available.

The report points out that the Great Lakes Drainage Basin is the only area in the United States having the necessary water for unlimited industrial expansion and that the

Central is unique in having the real estate to provide water distribution throughout the entire basin.

The concept is particularly timely in view of the recent serious drought throughout the Eastern United States. In many communities in the Northern Ohio Study area, this was the major issue in last week's elections and administrations are committed to provide water in some way. If the Central could step in with a master plan to provide raw Lake Erie water to these areas (and to industrial sites), we would receive immediate support from all levels of state and local government. By limiting our activities to wholesale raw water (required by industry), we would permit local governments to own and operate their treatment and distribution facilities.

We would welcome the opportunity of discussing this further with you, because we believe that the future will prove that water is the greatest single asset enjoyed by the New York Central.

We also enclose as information an article from the Cleveland Plain Dealer of November 7.

Mr. W. R. Grant: J. J. Wright.

PROPOSAL

1. The New York Central to enter a program of transporting water from Lake Erie along its rights of way to the back areas of the watershed.

2. Acquisition of Ohio Water Service Company to achieve entry into this program.

ADVANTAGES TO NEW YORK CENTRAL

1. Revenue will be produced from sale of water to industry, municipalities and agricultural activities.

2. Realization of increased tonnage from industry and commerce which must locate in the areas where water has been made available.

3. With confidential knowledge as to routing and scheduling of transport main construction, land can be purchased beforehand and disposed of at substantial profits after water improvement has been completed.

CONCLUSION

It is evident by the scope and nature of the first above proposal, that a comprehensive study by competent personnel would be required in order to fully evaluate the potential of this program. Most of the study areas are outlined in Mr. J. J. Wright's letter dated October 8, 1965 under Feasibility Studies. Letter is attached. Some areas could be studied by Central's personnel in the real estate, law and engineering departments before soliciting outside advice.

A preliminary evaluation of the water of Lake Erie should be undertaken as a first step. The potability of this water could be of long range significance to the overall success of a water transport system. Both Time magazine and U.S. News and World Report have indicated that Lake Erie is polluted. One source estimated that pollution control could cost the bordering states of Lake Erie a billion dollars apiece.

An article in the September, 1965 issue of Water Works and Wastes by Dr. Emmett W. Arnold, Director of the Ohio Department of Health indicates that Ohio is amply supplied with water at present and it doesn't seem likely that Ohio should experience serious trouble in the near future. (Part of this article is reproduced as Exhibit I, attached). This adequate supply of water exists with only a 2% utilization of Lake Erie water in the Lake Erie watershed area. This situation could detract from the value of our proposal, unless this project supplies the few areas in Ohio that have experienced water shortages.

Other areas that warrant examination are as follows:

1. Procedures involved in obtaining a water utility franchise from the State of Ohio Public Utilities Commission.

2. Estimates of increased tonnage and commerce which could relocate on our lines.

Our examination of Ohio Water Service Company indicates that this Company does not offer any unique investment value at this time. Should this Company prove of value in supplementing the overall system, further study of its franchise position should be made. Ohio Water Service Company is currently contesting two franchise cases in the courts.

Some study can be made of alternative methods of solving the water problem currently facing the United States as they may reflect the profitability of a transport system. Some solutions other than a transport system are saline water conversion, conservation and development of available fresh water supplies through construction of dams and reservoirs, conservation practices and programs, pollution control, industrial re-use of water and reclaiming sewage.

[EXHIBIT I]

SEPTEMBER 1965, ISSUE OF WATER WORKS AND WASTES BY DR. EMMETT W. ARNOLD, DIRECTOR OF THE OHIO DEPARTMENT OF HEALTH

Ohio is blessed with an average annual rainfall of 36 to 38 inches, about 75 billion gallons daily, or for a one third available run-off, the average daily supply is about 25 billion gallons. Present domestic and industrial water usage is about 12 billion gallons a day. Assuming that the population of Ohio will double in 25 to 30 years, the total water usage then would be equivalent to the average daily run-off. This, however, is not the limit of Ohio's

water supply. Some 120 billion gallons of water a day flow past Cleveland in Lake Erie, and some 60 billion gallons a day flow past Cincinnati in the Ohio River. Much of this of course is run-off from other states. In addition Ohio also has a rich underground supply of water.

Despite these blessings of rich water supply, Ohio already has had some problems of water shortage in a few areas, principally near water divides. Additional water storage will be necessary in the future and the state has encouraged not only the building of storage dams but also the protection of possible future water reservoir sites from encrouchment.

OHIO WATER SERVICE CO.

Current Price—32.
Earned Per Share (1964 Earnings)—$1.99.
Payout Ratio—80%.
Price Earning Ratio—16.

BUSINESS

Supplies treated water without competition for domestic and industrial purposes to various cities and communities located in Ohio including Massillon, Marysville, Washington Court House, Struthers, Poland, Campbell, and other communities adjacent to Youngstown in Mahoning County. The total population served is 175,000. The Company also operates an untreated water supply system serving 18 industrial customers and railroads in Youngstown and a 12 mile stretch along the Mahoning River Valley with non-potable water. Non-potable water sales provided 16% of 1964 water revenue.

GENERAL

Of 1964 water revenues, residential and commercial sales accounted for 71%, industrial 22% and all other 7%. Steadily growing residential services and lessened dependence on highly cyclical non-potable water sales to Youngstown area steel-mills has been a stability factor.

The Company is contesting in the Courts two actions of the City of Willoughby applicable to 1,200 customers served. These are a reduction in rates of $35,000 a year so that the Company's tariff would not exceed that of municipal water and proceedings to municipalize the Willoughby water system that could reduce gross revenues by an additional $35,000.

Ohio Water Service has maintained a liberal payout ratio above 80% for the past 7 years. These are dividend restrictions on the stock but they are of no consequence at present. This Company has a convertible 6% bond issue due in 1977. Bonds are convertible if called into 40.10 shares per $1,000 bond and such conversion would dilute earnings per share 21.2%. It is not likely that Ohio Water Service Co. would force conversion by exercising this call feature.

RECOMMENDATION

Ohio Water Service has increased total operating revenue in each of the past ten years at a ten year growth rate of 9.5%. This improvement has continued in the first six months of 1965. Earnings have experienced a somewhat lower growth rate of 4.7% throughout this same period. Ohio Water is burdened with a very high debt as a percent of total capital, 68% in 1964; fixed charges earned has consistently approximated two times since 1959. The Company has had a deficit in working capital in eight of the past ten years; the 1964 deficit was $1,790,051. Although this working capital position is somewhat typical of water utility companies, this Company has not been able to make improvements since 1961.

Ohio Water Service Co. could prove to be a suitable investment if New York Central RR decides to enter the water business in the Lake Erie watershed area in the proportion outlined by the Preliminary Study of a Water Transport System. Further study of the franchise position of this Company would be necessary if purchase is further considered.

R. P. STOCKMAN.

EXHIBIT 6

NEW YORK CENTRAL SYSTEM,
Collinwood, Ohio, October 8, 1965.

MR. A. E. PERLMAN,
President, New York Central System,
New York, N.Y.:

In view of the investments that the Pennsylvania is making in real estate, we think it might be time to reconsider the possibility of using railway rights-of-way as a water distribution network.

Please refer to Mr. J. O. Boisi's letter of February 20, 1964 on this subject, copy attached. At a later date we discussed this matter with him personally. With the concentration of population building up in the New York Central territory it may be well to restudy this matter.

Considering northern Ohio as an example, we are enclosing a map indicating principal streams and their drainage areas on which we have noted numerically and circled the major drainage basins, the Central's trackage, and the specific areas referred to in our suggestions below. Drainage Basins Nos. 1, 2, 3, and 4 are well traversed by our rights-of-way while we have a minimum ownership in Nos. 5 and 6. Area No. 5 affords the least potential for establishing a water transport system since the greater portion of the

land area is served by the municipally-owned water systems of Cleveland and Akron. Area No. 6 has, in the past few years, experienced a rapid growth of heavy industry and our comments under Ohio Water Service Company pertain to this area.

We have the following suggestions for concurrent action to be taken:

1. Acquisition of Ohio Water Service Company.—Brief reference was made in our report of November 8 to two firms engaged in the distribution and sale of water in Ohio. Further study of their operations leads to the recommendation that the Central purchase the Ohio Water Service Company to achieve immediately the following benefits:

a. The Company's operations have consistently yielded adequate returns. These returns would bolster the Central's water program in the early days of formation and construction. Details of the Company's earnings and related information appear on the latest stock report compiled by Standard & Poor's which is enclosed.

b. The areas indicated in red on the attached map may have, in our opinion, the greatest growth potential in the study area and the cities of Mentor and Geneva-on-the-Lake presently served by the Ohio Water Service Company provide an ideal nucleus for development of one of these areas.

c. The Company's administrative and operating personnel would assure Central's orderly entry into the water transport program and would provide the nucleus for training additional personnel.

2. State of Ohio Water Survey.—The State, through its Department of Development, has in recent days authorized a study to determine the feasibility of constructing a 240-mile water supply system in the Maumee River Basin. This area is delineated in yellow on the enclosed map. We understand a preliminary report was due in April 1964 and a final report in December 1964. We would recommend that a close examination be made of the content of the final report in the following areas:

a. The use of the Central's right-of-way.

b. Routing which would enhance the value of our properties in the area.

c. Possible ownership of a part of a network.

3. Feasibility Studies.—The area shaded in blue on the enclosed map represents the remaining portions of the Lake Erie watershed area located in Ohio which have not been subjected to comprehensive studies and for which no master plan exists. We would recommend that selected portions of this area plus the areas indicated in red be studied in detail to determine its potential and our best course of action. Such a study could include:

a. Study of industrial and associated population growth along with projections to the year 2000.

b. Study of the water resources of the United States and the translation of the effect of its diminishing per capita availability on the growth of the Great Lakes area and specifically the study area.

c. An analysis of existing surface transportation which would contribute to accelerated growth in any given locality.

d. A survey of communities and areas which experienced severe water shortages during the record drought of 1963. This survey would produce consumption data which would determine in part the initial elements of construction. It is noted that the drought-stricken communities are currently negotiating with central water authorities. However, actual service appears to be years in the future due to the traditionally slow-moving pace of governmental units.

e. Determination of those areas which are to receive raw water service and those where it is economically feasible to construct treatment of local distribution facilities, if any.

f. Preparation of a water transport system designed in preliminary form based on current and projected requirements. Inspection of various features and ownership status of our rights-of-way. Such a design would also consider the status of abutting lands with an eye to real estate sales and freight traffic development to produce the highest over-all rate of return.

g. Preparation of preliminary construction cost estimates and rate schedules.

It is our estimate that such a study could be accomplished by a competent engineering organization for approximately $25,000.

4. Industrial Development.—Concurrent with the above, it would be possible to place greater emphasis in our industrial development program on the utilities' features of sites and their realtionship to municipal ownership and corporate boundaries. This point can best be illustrated by examining in some detail the parcel designated as Site A in the New York Central brochure entitled "The Greater Lorain-Elyria-Sandusky, Ohio Area," Exhibit A–1 enclosed. The total site contains 370 acres of which 150 are in the city of Elyria and the remaining 220 in the city of North Ridgeville. Exhibits A–2 and A–3 illustrate the preliminary subdivision layout prepared by a local engineering consultant for a group of realty interests examining this site. The water and sewer services are owned by the city of Elyria and it is the availability of water which makes the site particularly attractive and valuable. It is the concensus of opinion of realtors and professional planners that the promotion and development of the site can be accomplished only when considering the entire 370 acres and it is materially less attractive when restricted to the area in Elyria. The rail frontage in Elyria is not sufficient to attract the type of heavy industry which would in turn necessitate the support of auxiliary enterprises in other areas of the parcel. The realty interests further state that the profits realized from development would not adequately balance the promotional costs where only the Elyria parcel is involved.

Various groups have, in the past, attempted to develop the total parcel but have been invariably frustrated by Elyria's refusal to extend its services to that section lying in North Ridgeville. At this point, it appears that the solution to the development of the 370 acres lies in the private ownership of utility systems which are not encumbered by corporate boundaries or municipal antagonisms.

J. J. WRIGHT.

NEW YORK CENTRAL SYSTEM,
New York, February 20, 1964.

MR. J. J. WRIGHT: This will acknowledge receipt of your letter dated February 17th concerning the article appearing in Engineering Outlook published by the University of Illinois dealing with the growing shortage of potable water.

Upon receipt of your letter of November 8th, I arranged with our legal counsel to investigate the legal ramifications involved in engaging in the operation of a water distribution system. I have also discussed with several investment bankers the economic feasibility of such an arrangement. General discussions have also been held with private water companies concerning the use of our right-of-way properties. As a matter of fact, intensive negotiations are presently going on with the Onondaga Water Authority for the use of our right-of-way for the transmission of water from Lake Ontario. All of the work we have done so far on this subject indicates that although the idea is a capital one, it is replete with problems—not the least of which involves the title to our right-of-way. From all correspondence, I am certain that you are not aware of the fact that a good portion of our right-of-way is not owned outright in fee by us.

In your letter of the 17th, you have made some general comments concerning the need for action on this subject. I would welcome clear-out, specific suggestions on the subject

J. O. BOISI.

EXHIBIT 7

[Memorandum of S. T. Saunders used at P.C.T.C. Board of Directors Meeting, June 1968]

KAYSER-ROTH

Before proceeding with the regular business of the meeting, there is a preliminary matter of importance that I would like to present for your consideration and appropriate action.

At our meeting in March management was authorized to negotiate with representatives of Kayser-Roth Corporation as a potential acquisition in our long-range diversification program. In the intervening months, Dave Bevan, Bill Gerstnecker and our lawyers have been actively studying this company. Yesterday, they reached final agreement with the Kayser-Roth management on the terms of a proposed plan which will be presented for your consideration in just a moment.

Technically, the proposed transaction calls for merger of Kayser-Roth into the Pennsylvania Company, so, assuming favorable action on the part of this Board, we will recess this meeting and present the matter to the Directors of the Pennsylvania Company (all of whom are present), then reconvene this Board to conclude the Penn Central business.

Simultaneously, the plan is being presented to the Directors of Kayser-Roth, who are now in session at their executive offices at 640 Fifth Avenue. Assuming all necessary approvals are obtained, Chester Roth and several of their officers will come here to 230 Park Avenue to execute the agreement.

Although we are not anxious to generate a lot of fanfare about the transaction, following the signing we will issue a press release to comply with S.E.C. and Stock Exchange rules concerning public disclosure.

Before going into the details of the plan, I would like to mention some of the fundamental objectives of our diversification program which have served as guideposts in investigating the merits of this particular investment. First, of course, are the minimum requirements of profit, growth potential and beneficial use of our tax shelter.

Next, we feel that a company must be sufficiently large and established as a going concern to insure perpetuation and growth with existing management. In other words, we are seeking to become investors in profitable firms, not managers. Transportation companies and basic industries which are large users of railroad service are not prime candidates because of potential conflict with certain anti-trust theories and regulatory policies of the ICC. In addition, we have no desire indeed, cannot compete with some of our best customers.

Another objective is to coordinate our diversification program with the requirement that we divest ourselves of our N&W holdings within the next seven years. This accomplishes two results in one transaction. It also improves acceptability of the diversification in the eyes of the Government, at whose insistence the divestiture is taking place. Moreover, there are the obvious advantages in using securities, rather than cash, in a transaction of this size.

Another requirement is to make the acquisition in a clear-cut, business-like way, in order to eliminate the prospects of proxy fights and price competition. In this connection, the people with whom we are dealing control 40% of the outstanding stock of Kayser-Roth, and there is every reason to believe that we can successfully consummate any transaction that is agreed upon today within ninety days.

In our opinion, the transaction that Mr. Bevan will describe to you will meet each of the objectives that I have outlined. I have met Chester Roth and members of his management on only one occasion, but I was favorably impressed by the calibre of the people and what they had to say. Moreover, I am impressed with Kayser-Roth as a company. It is unquestionably a leader in its field. It operates 119 plants—mostly in the Carolinas, but it also has a number of licensees abroad. Kayser-Roth is not in the high-fashion business, and it is not a maker of suits and dresses, which are the volatile segments of the clothing industry. Rather, it manufactures and markets standard apparel products and accessories under some of the best known brand names in the business, including—

Kayser and Shiaparelli hosiery;
Catalina and Cole-of-California sportswear;
Esquire and Interwoven socks;
Excello shirts;
Paris belts; and
Kayser and Majud gloves.

The company is right now in the process of acquiring Commonwealth Shoe Company.

With this short introduction, Mr. Bevan, won't you please fill the members of the Board in on the details of the proposed acquisition.

Exhibit 8

August 14, 1968.

D. C. Bevan: What is your schedule for submitting the Kayser-Roth proxy material to the SEC and filing the ICC application? It would be helpful to be in a position to include the income in our consolidated third-quarter earnings.

S. T. Saunders.

Exhibit 9

May 28, 1968.

Mr. Saunders: You will recall that we obtained clearance from members of the Finance Committee to discuss with Kayser Roth possible acquisition terms to determine whether a transaction could be recommended. Since then, I understand from you some Board members have expressed doubt as to the advisability of such transaction. Yesterday afternoon, I indicated that the discussions with their chief executive would be completed very shortly and this occurred last evening. In my judgment, if both Boards approve, we could reach an understanding that would be extremely attractive, and would add substantially to our earnings, and would continue to do so in the future, and should thus have a favorable effect on the market value of our stock.

I would like to sit down and review the situation with you in detail as quickly as possible so you can determine whether the terms discussed should be recommended to the Committee and the Board or whether the matter should be dropped. Obviously, the time factor is very important and the decision will be equally important.

David C. Bevan.

Exhibit 10

[Tabular information and attachments submitted by railroad pursuant to request of Committee's special staff]

Selected Subsidiaries—Analysis of Purchase of Investments—Period 1964–69

PURCHASE OF INVESTMENTS, 1964–69

[In thousands]

Owning company	Investment—nonrailroad	Cash	Noncash	Tota
Pennsylvania Co.	Buckeye Pipe Line, 100 percent	$30,381	$69,912	$100,293
Do	Arvida Corp., 58 percent	22,046		22,046
Do	Great Southwest Corp.[1]	51,826		51,826
Do	Macco Corp.[1]	39,451		39,451
GSC and Macco total		91,277	0	91,277
Pennsylvania Co. total		143,704	69,912	21,361
P.C.T	Strick Corp., 100 percent	24,437		24,437
American Contract (P.C.T.)	Executive Jet Aviation—nonvoting interest	20,497		20,497
P.C.T	Madison Square Garden, 23 percent	6,697	21,000	27,697
Total, nonrailroad investment		195,335	90,912	286,247

[1] 82 percent combined.

PENNSYLVANIA CO.—INVESTMENT IN BUCKEYE PIPE LINE CO.

[Dollars in thousands]

	Purchases	
	Shares	Cost (thousands)
1963:		
1st quarter	171,200	$5,029
2d quarter	28,100	891
3d quarter	4,000	117
4th quarter	633,260	22,132
Year 1963 total	836,560	28,169
1964:		
1st quarter	54,054	1,859
3d quarter	1,815,905	70,265
Total holdings	2,706,519	100,293
1964: July merger plan—shares exchanged (100 percent)	14,000	100,293

Note: The initial holdings in Buckeye were acquired through cash purchases of stock in 1963 and early in 1964 approximating $30,000,000. In July of 1964 Pennsylvania Co. issued $70,000,000 of preferred stock in exchange for the balance of the Buckeye stock outstanding. The preferred stock was issued convertible into Norfolk & Western stock held by Pennsylvania Co. ($317 par of Pennsylvania Co. for each N. & W. share). The cash used for the initial stock purchases was available from working capital sources of Pennsylvania Co.

PENNSYLVANIA CO.—INVESTMENT IN ARVIDA CORP.

	Purchases	
	Shares	Cost (thousands)
1965: 3d quarter	3,055,877	$18,335
1966:		
1st quarter	128,600	1,044
2d quarter	225,600	1,920
3d quarter	91,700	579
4th quarter	27,500	168
Year 1966 total	473,400	3,711
Total (58 percent)	3,529,277	22,046

Note: The initial acquisition of Arvida stock was made in July 1965 (as shown above—3d quarter 1965) from the estate of A. V. Davis A cash payment of $5,215,000 was made and a note given for the balance which has since been redeemed from funds obtained out of working capital. The other smaller purchases of stock were made in the market for cash from working capital sources.

Pennsylvania Co. investment in Great Southwest Corp.

Purchases:	*Cost*
Preferred stock	$6,880,000
Common stock	83,344,000
Convertible bonds	53,000
Total investments	91,277,000

PENNSYLVANIA CO. INVESTMENT IN GREAT SOUTHWEST CORP. (INCLUDES MACCO CORP.)

Purchases	Shares	Cost (thousands)
Series A 6 percent cumulative preferred stock:		
1966 4th quarter (conversion of debt)	350,000	$3,500
1969 2d quarter (10-for-1 split)	3,150,000	
	3,500,000	3,500
Series A 6½ percent senior cumulative preferred stock:		
1967 4th quarter	50,000	500
1969 2d quarter (10-for-1 split)	450,000	
	500,000	500
Series B 7 percent cumulative preferred stock: 1969 2d quarter (Macco merger and 10-for-1 split)	3,650,000	513
Series C 7.6 percent cumulative preferred stock: 1969 2d quarter (Macco merger and 10-for-1 split)	16,410,980	2,367
Total		6,880

PENNSYLVANIA CO. INVESTMENT IN GREAT SOUTHWEST CORP. (INCLUDES MACCO CORP.)

Purchases	Shares	Cost (thousands)
Common stock:		
1963:		
1st quarter	1,200	22
3d quarter	4,000	66
4th quarter	2,500	46
Year 1963	7,700	134
1964:		
1st quarter	300	5
2d quarter	2,000	39
3d quarter	574,367	13,071
4th quarter	92,500	1,762
Year 1964	669,217	14,877
1965:		
1st quarter	53,455	1,082
2d quarter	32,640	681
3d quarter (includes 210,211 warrants at a cost of $2,550,000)	25,450	3,153
4th quarter	33,800	1,207
Year 1965	145,345	6,123
1966:		
1st quarter	6,731	278
2d quarter	13,860	579
3d quarter	1,200	41
4th quarter	2,800	83
Year 1966	24,591	981
1968:		
1st quarter	3,100	149
4th quarter	9,473	297
Year 1968	12,573	446
1969:		
1st quarter:		
Macco merger	577,303	15,268
Do	8,060,950	21,304
2d quarter (10-for-1 split)	12,930,561	
4th quarter	1,400,610	25,211
Year 1969	22,969,424	61,783
Total	23,828,850	[1] 84,344

[1] 82 percent.

NOTES

The initial acquisition of 3,500,000 shares of 6 percent cumulative preferred stock was the result of the conversion of debt for stock and a 10-for-1 stock split. In connection with the merger of Macco into Great Southwest in March 1969, 3,650,000 shares of its series B, 7 percent cumulative preferred stock, and 16,410,980 shares of its series C, 7.6 percent cumulative preferred stock were issued. The 6½ percent nonvoting, A, preferred stock was purchased from working capital funds in December 1967 and subsequently adjusted for a 10-to-1 stock split.

Controlling interest in Great Southwest stock was made in the 3d quarter 1964 by the piecemeal purchase of 574,367 shares in the market for cash of $13,071 with funds obtained from working capital. The 60-percent interest in common stock acquired by the end of 1964 increased to 75 percent by the end of 1966. These additional purchases of stock were made in the market for cash from working capital sources. In December 1968, 6 percent subordinated convertible notes of $297 were converted into common stock (as shown above—4th quarter 1968) for 9,473 shares.

In March 1969, in connection with the merger of Macco into Great Southwest, 577,303 shares of common stock were issued to the Pennsylvania Co. In April 1969, Pennsylvania Co. converted Great Southwest series D 4½-percent preferred stock (received in connection with the Macco merger) into 8,060,950 shares of common. During the same month a 10-for-1 stock split increased the number of common stock owned by 12,857,661 shares. In December 1969 Great Southwest issued 1,400,610 shares of its common stock to Pennsylvania Co. in consideration of the cancellation of debt aggregating $25,211. This debt resulted from advances (1967 through 1969) by Pennsylvania Co. to Great Southwest of $23,058 and income-tax allocation of $2,153. The $23,000,000 of advances was obtained from Pennsylvania Co. working capital.

PENNSYLVANIA CO.—INVESTMENT IN MACCO REALTY CO.

Purchases	Shares	Cost (thousands)
Common stock:		
1965:		
3d quarter	8,000	$8
4th quarter	72,000	72
Total	80,000	80
Class B, 6 percent cumulative preferred:		
1965: 4th quarter	2,812,193	39,371
Total		39,541

Note: In March 1969. Macco merged into Great Southwest, In connection with the merger, Great Southwest issued 577,303 shares of its common stock, 3,650,000 shares of its series B, 7 percent cumulative preferred stock, 16,410,980 shares of its series C, 7.6 percent cumulative preferred stock in exchange for Pennsylvania Co.'s investment in Macco (as shown above).

The $39,400,000 required for the purchase of Macco was obtained from the proceeds of sale by Pennsylvania Co. to the transportation company of $40,000,000 of bonds of the transportation company.

Penn Central Transportation Co. investment in Strick Companies

Purchases:	
Common stock:	
1966 4th quarter (note—paid in cash in 1967)	$4,200,000
1967 1st quarter	10,800,000
Note: 1968 4th quarter	9,437,000
Total	24,437,000

AMERICAN CONTRACT—INVESTMENT IN EXECUTIVE JET AIRWAYS, INC.

Purchases	Shares	Cost (thousands)
Common stock:		
1965:		
2d quarter	655,960	$328
4th quarter	(110,000)	(55)
Year 1965 total	545,960	273
1966: 1st quarter (legal fees)		4
1967:		
2d quarter	3,445	2
4th quarter	110,000	66
Year 1967 total	113,445	68
Total	659,405	345

Note: The acquisitions of common stock from 1965 through 1967 were made with working capital funds.

Advances: 1968–69	$6,287
Notes: 1967	13,865
Total	20,497

PENN CENTRAL TRANSPORTATION CO.—INVESTMENT IN MADISON SQUARE GARDEN CORP.

Purchases	Shares	Cost (thousands)
Common stock:		
1968: 4th quarter	2,319,664	$25,697
1969:		
1st quarter	85,756	950
2d quarter	18,054	200
3d quarter	76,728	850
Year 1969	180,538	2,000
Total	2,500,202	27,697

Note: The initial acquisition of Madison Square Garden Corp. was made in December 1968 (as shown above, 4th quarter 1968) with the exchange of the outstanding shares of Pennsylvania Terminal Real Estate Corp., 25 percent of the outstanding stock of Madison Square Garden Center, Inc., and the forgiveness of certain indebtedness due from Pennsylvania Terminal Real Estate Corp. for 2,319,664 shares of common stock. The acquisition cost of $25,697 included a cash investment of $4,697 and a profit of $21,000 resulting from the exchange. The initial cash investment and subsequent purchases made in 1969 were from working capital funds.

PENN CENTRAL CO., INVESTMENT IN SOUTHWESTERN OIL & REFINING CO., AND ROYAL PETROLEUM CORP.

Purchases	Shares	Cost (thousands)	Percent
Common stock (1970 1st quarter):			
Southwestern Oil & Refining Co	400,000	$21,083	
Royal Petroleum Corp	400,000	5,114	
Total	800,000	26,198	100

Note: In February 1970 Penn Central Co. purchased Southwestern Oil & Refining Co. and Royal Petroleum Corp. through the issuance of 400,000 shares of its $3 cumulative preference stock.

GREAT SOUTHWEST CORP.—COMMON STOCK

PENNSYLVANIA CO.

Date	Purchased from—	Shares	Cost
1964			
July 2	Hemphill, Noyes & Co	2,500	$53,750
15	Rockefeller Center Inc	170,851	3,844,148
15	First National Bank of Dallas	347,516	7,819,110
15	Glore Forgan, Wm. R. Staats Inc		259,183
22	do	2,000	41,500
Aug. 14	do	34,500	721,482
25	do	2,000	40,000

GREAT SOUTHWEST CORP.—COMMON STOCK—Continued

PENNSYLVANIA CO.—Continued

Date	Purchased from—	Shares	Cost
Sept. 1	do	2,000	39,750
8	do	2,000	39,500
15	do	4,000	77,500
18	do	2,000	38,750
28	do	2,000	38,500
30	do	3,000	58,125
Oct. 14	do	2,500	49,062
19	do	2,000	38,750
Nov. 17	do	4,000	77,000
18	do	2,500	48,125
30	Republic National Bank of Dallas	71,350	1,355,650
Dec. 4	First National Bank of Dallas	10,200	193,800
1965			
Jan. 21	Glore Forgan, Wm. R. Staats Inc	24,000	462,000
25	Merrill Lynch, Pierce, Fenner & Smith, Inc	9,555	181,618
25	Carrington, Johnson & Stephens—Legal fee		3,794
Feb. 1	Merrill Lynch, Pierce, Fenner & Smith, Inc	3,100	58,923
Mar. 9	Glore Forgan, Wm. R. Staats Inc	1,500	32,813
11	Merrill Lynch, Pierce, Fenner & Smith, Inc	2,075	47,300
15	Glore Forgan, Wm. R. Staats Inc	2,000	45,500
19	do	3,000	68,625
25	do	3,000	67,125
29	do	2,000	44,000
30	Silberberg & Co	1,000	21,500
31	Merrill Lynch, Pierce, Fenner & Smith, Inc	1,725	37,147
Apr. 5	do	240	5,140
5	First National Bank of Dallas	8,600	163,400
8	Merrill Lynch, Pierce, Fenner & Smith, Inc	200	4,307
14	Glore Forgan, Wm. R. Staats Inc	2,500	54,062
20	Merrill Lynch, Pierce, Fenner & Smith, Inc	500	10,766
20	Glore Forgan, Wm. R. Staats Inc	4,500	96,896
30	Merrill Lynch, Pierce, Fenner & Smith, Inc	200	4,307
May 3	Carrington, Johnson & Stephens—Expenses		965
4	Bruce Benjamin	4,000	85,000
10	Merrill Lynch, Pierce, Fenner & Smith, Inc	600	12,844
12	Glore Forgan, Wm. R. Staats Inc	5,000	106,875
19	Merrill Lynch, Pierce, Fenner & Smith, Inc	200	4,231
June 1	Eppler, Guerin & Turner, Inc	500	10,625
9	Merrill Lynch, Pierce, Fenner & Smith, Inc	700	15,161
11	do	1,800	38,986
21	Glore Forgan, Wm. R. Staats Inc	1,500	32,250
21	Merrill Lynch, Pierce, Fenner & Smith, Inc	200	4,281
23	Eppler, Guerin & Turner, Inc	500	10,812
23	Merrill Lynch, Pierce, Fenner & Smith, Inc	900	19,607
July 6	Glore Forgan, Wm. R. Staats Inc	4,000	80,000
9	Merrill Lynch, Pierce, Fenner & Smith, Inc	900	19,266
13	Eppler, Guerin & Turner, Inc	500	10,688
20	do	600	12,900
Aug. 3	Glore Forgan, Wm. R. Staats Inc	2,000	47,000
4	do	5,500	129,938
4	Eppler, Guerin & Turner, Inc	2,000	46,750
5	do	3,000	70,500
12	Merrill Lynch, Pierce, Fenner & Smith, Inc	100	2,456
11	do	350	8,554
25	do	400	10,327
Sept. 1	Eppler, Guerin & Turner, Inc	1,500	40,500
1	Glore Forgan, Wm. R. Staats Inc	1,000	25,375
13	Eppler, Guerin & Turner, Inc	1,000	27,312
16	Dewar, Robertson & Pancoast	1,000	27,625
21	Eppler, Guerin & Turner, Inc	500	13,875
23	Glore Forgan, Wm. R. Staats Inc	1,100	29,975
23	do		2,550,000
Oct. 4	do	5,000	158,609
18	Merrill Lynch, Pierce, Fenner & Smith, Inc	9,500	326,421
19	Glore Forgan, Wm. R. Staats Inc	1,000	34,250
26	do	1,000	35,500
Dec. 3	do	2,000	78,000
6	do	1,000	39,000
13	do	10,100	385,618
28	do	3,000	107,500
28	Eppler, Guerin & Turner, Inc	700	24,850
31	Glore Forgan, Wm. R. Staats Inc	500	17,375
1966			
Jan. 13	do	1,000	38,500
Feb. 9	do	1,000	41,000
Mar. 3	do	31	1,193
11	Angus G. Wynne, Jr	2,000	84,901
24	Glore Forgan, Wm. R. Staats Inc	700	29,400
30	do	2,000	83,500
31	Pennsylvania RR	5,500	231,000
Apr. 11	Eppler, Guerin & Turner, Inc	430	18,006
18	Glore Forgan, Wm. R. Staats Inc	2,500	104,688
21	Eppler, Guerin & Turner, Inc	200	8,279
22	do	590	24,780
May 3	do	200	9,275
5	do	100	4,642
9	Merrill Lynch, Pierce, Fenner & Smith, Inc	500	23,210
10	Eppler, Guerin & Turner, Inc	1,300	61,100
12	Merrill Lynch, Pierce, Fenner & Smith, Inc	100	4,391
16	Eppler, Guerin & Turner, Inc	1,200	50,650
17	Blyth & Co., Inc	200	8,480
18	do	40	1,700
23	Glore Forgan, Wm. R. Staats Inc	500	20,752
June 20	Republic National Bank of Dallas	5,000	200,000
29	Eppler, Guerin & Turner, Inc	1,000	39,000

GREAT SOUTHWEST CORP.—COMMON STOCK—Continued

PENNSYLVANIA CO.—Continued

Date	Purchased from—	Shares	Cost
July 5	Glore Forgan, Wm. R. Staats Inc	500	19,500
25	Eppler, Guerin & Turner, Inc	300	10,275
Sept 19	Glore Forgan, Wm. R. Staats Inc	400	11,900
Oct. 3	Yarnall, Biddle & Co	200	6,000
3	Glore Forgan, Wm. R. Staats Inc	1,000	29,750
10	do	1,000	29,275
25	do	600	17,700
1968			
Dec. 9	Conventional 6 percent notes	9,473	357,101
1969			
Mar. 21	Received in exchange for Macco securities at time of merger into GSC	1,383,398	36,570,801
	Total	2,234,724	59,085,458
Apr. 21	10 for 1 stock split	22,347,240	
Dec. 31	Exchange of debt held by Pennsylvania Co., for stock	1,400,610	25,210,980
	Total	23,747,850	84,296,438

PENNSYLVANIA RR. CO.

Date	Purchased from—	Shares	Cost
Feb. 26, 1962	Glore Forgan, Wm. R. Staats Inc	1,200	$21,900
July 25, 1963	do	4,000	66,000
Dec. 20, 1963	Yarnall, Biddle & Co	500	9,250
Dec. 23, 1963	Hemphill, Noyes & Co	500	9,250
Dec. 27, 1963	Glore Forgan, Wm. R. Staats Inc	1,000	18,500
do	Brooke, Sheridan, Bogan & Co., Inc	500	9,250
Jan. 3, 1964	Fulton, Reid & Co., Inc	300	5,550
June 19, 1964	Vlore Forgan, Wm. R. Staats Inc	1,500	28,975
June 25, 1964	do	500	9,812
Mar. 8, 1965	do	500	11,250
Jan. 18, 1968	do	1,000	43,500
Jan. 31, 1968	do	1,000	43,000
Mar. 29, 1968	do	500	28,500
do	Eppler, Guerin & Turner, Inc	600	33,800
Total		13,600	338,537
Mar. 31, 1966	Sold to: Pennsylvania Co. (Proceeds—$231,000)	5,500	100,387
		8,100	238,150
Apr. 21, 1969	10 for 1 stock split	72,900	
		81,000	238,150

GREAT SOUTHWEST CORP.

Date: Purchased from—	Shares	Cost
SERIES A SENIOR 6½ PERCENT PREFERRED STOCK		
Penn Central Transportation Co.:		
October 3, 1967: Great Southwest Corp	50,000	$500,000
April 25, 1969: 10 for 1 split	450,000	
Total	500,000	500,000
SERIES A 6 PERCENT PREFERRED STOCK		
Pennsylvania Co.:		
July 15, 1966: Great Southwest Corp	350,000	3,500,000
April 25, 1969: 10 for 1 split	3,150,000	
Total	3,500,000	3,500,000
SERIES B 7 PERCENT PREFERRED STOCK		
Pennsylvania Co.:		
March 21, 1969: See note	3,650,000	512,859
SERIES C 7.6 PERCENT PREFERRED STOCK		
Pennsylvania Co.: March 21, 1969: See note	16,410,980	2,367,042

Note: Received in exchange for Macco securities at time of merger into Great Southwest and adjusted for 10 for 1 split.

ARVIDA CORP.—PENNSYLVANIA CO. PURCHASES

Date		Shares	Cost
	Purchased from:		
Aug. 19, 1965	R.S. Hudson & Co., Inc.	3,800	$22,800
Sept. 30, 1965	Pennsylvania RR	3,052,077	18,312,462
Jan. 7, 1966	Glore Forgan, Wm. R. Staats Inc.	14,000	133,000
Feb. 28, 1966	do	8,000	62,000
Mar. 31, 1966	Andresen & Co.	85,500	684,000
Do	Glore Forgan, Wm. R. Staats Inc.	6,000	46,500
Do	Silberberg & Co.	15,100	118,913
Apr. 13, 1966	Glore Forgan, Wm. R. Staats Inc.	2,000	16,500
Apr. 20, 1966	Carl M. Loeb Rhoades & Co.	100,000	916,000
June 7, 1966	do	2,500	20,059
June 9, 1966	Dooly, Gerrish & Co. Inc.	15,600	124,800
June 10, 1966	State Street Investment Corp.	99,000	792,000
Do	Silberberg & Co.	1,400	11,375
June 14, 1966	Dominick & Dominick	2,500	19,063
June 21, 1966	Silberberg & Co.	2,600	20,150
July 5, 1966	Glore Forgan, Wm. R. Staats Inc.	2,500	19,063
July 15, 1966	do	1,000	7,250
Do	do	1,000	7,250
July 20, 1966	do	2,000	14,500
July 25, 1966	do	1,000	7,000
July 27, 1966	Blyth & Co. Inc.	5,000	35,000
Aug. 24, 1966	do	3,500	23,187
Sept. 1, 1966	Glore Forgan, Wm. R. Staats Inc.	71,700	439,521
Sept. 2, 1966	Blyth & Co. Inc.	4,000	26,250
Oct. 27, 1966	Cyrus J. Laurence & Sons	20,000	122,600
Dec. 15, 1966	do	5,000	30,650
Dec. 28, 1966	Silberberg & Co.	2,500	15,000
	Total	3,529,277	$22,046,893

PENNSYLVANIA RR. CO. PURCHASES

July 26, 1965	Purchased from: Estate of A. V. Davis	3,274,428	$19,646,568
	Sold to:		
July 26, 1965	Stockton, Whatley, Davin & Co.	222,351	1,334,106
Sept. 30, 1965	Pennsylvania Co.	3,052,077	18,312,462
	Total	3,274,428	$19,646,568

MACCO REALTY CO., COMMON STOCK—MACCO DEVELOPMENT CORP (A SUBSIDIARY OF PENNSYLVANIA CO.)

	Purchased from:		
Oct. 15, 1965	Tender offer	1,930,665	$27,484,548
Oct. 25, 1965	Kidder Peabody & Co.	500	7,000
Nov. 1, 1965	Glore Forgan, Wm. R. Staats Inc.	700	9,948
Nov. 5, 1965	do	50	712
Nov. 9, 1965	do	211	2,998
Nov. 16, 1965	do	80	1,136
Nov. 17, 1965	do	745	10,586
Nov. 18, 1965	do	200	2,842
Nov. 24, 1965	do	25	354
Nov. 26, 1965	do	40	568
Nov. 30, 1965	do	135	1,918
Dec. 2, 1965	do	6	85
Dec. 3, 1965	do	28	396
Dec. 7, 1965	do	30	426
Dec. 9, 1965	do	805	11,439
Dec. 14, 1965	do	50	711
Dec. 17, 1965	do	57	810
Dec. 20, 1965	do	50	707
Dec. 23, 1965	Kindel & Anderson—legal fees		100,765
Dec. 15, 1965	Cost of warrants purchased and canceled:		
	Mitchum, Jones & Templeton		
	Kidder, Peabody & Co.		62,195
Jan. 4, 1966	Glore Forgan, Wm. R. Staats Inc.	47	668
Jan. 6, 1966	do	21	298
Jan. 12, 1966	do	342	4,860
Jan. 14, 1966	do	150	2,132
Jan. 24, 1966	do	2,249	31,958
Jan. 25, 1966	do	25	355
Feb. 4, 1966	do	100	1,421
Feb. 9, 1966	do	114	1,620
Feb. 4, 1966	Printing and other expenses related to tender offer		5,217
Feb. 28, 1966	Glore Forgan, Wm. R. Staats Inc.	45	640
Mar. 4, 1966	do	50	711
Mar. 25, 1966	do	10	142
Mar. 29, 1966	do	25	355
Apr. 1, 1966	do	100	1,421
Apr. 28, 1966	do	30	426
July 11, 1966	do	115	1,634
July 22, 1966	Great Southwest acquisition costs		129,227
	Converted into Great Southwest stock	1,937,800	27,883,229

SIX-PERCENT CONVERTIBLE SUBORDINATED DEBENTURES DUE APR. 1, 1977—MACCO DEVELOPMENT CORP. (A SUBSIDIARY OF PENNSYLVANIA CO.)

Date		Par value	Cost
	Purchased from:		
Oct. 15, 1965	Tender offer	$3,117,000	$3,796,506
Oct. 18, 1965	Glore Forgan, Wm. R. Staats Inc	4,000	4,882
Oct. 21, 1965	do	11,000	13,425
Oct. 22, 1965	do	7,000	8,544
Nov. 10, 1965	do	1,000	1,221
Nov. 12, 1965	do	6,000	7,323
Dec. 3, 1965	do	1,000	1,220
Dec. 8, 1965	do	2,000	2,436
Dec. 9, 1965	do	2,000	2,441
Dec. 30, 1965	do	6,000	7,323
Apr. 18, 1966	do	1,000	1,221
Apr. 26, 1966	do	10,000	12,205
	Converted into Great Southwest stock	3,168,000	3,858,747

SIX-PERCENT CONVERTIBLE SUBORDINATED DEBENTURES DUE DEC. 1, 1978

Date		Par value	Cost
	Purchased from:		
Oct. 15, 1965	Tender offer	2,949,000	5,862,612
Oct. 18, 1965	Glore Forgan, Wm. R. Staats Inc	4,000	7,962
Oct. 22, 1965	do	3,000	6,032
	Adjustment for interest		(360)
Nov. 10, 1965	Glore Forgan, Wm. R. Staats Inc	5,000	10,052
Nov. 22, 1965	do	10,000	20,105
Dec. 15, 1965	do	1,000	1,991
Apr. 1, 1966	do	3,000	5,972
June 2, 1966	do	5,000	9,952
	Converted into Great Southwest stock	2,980,000	5,924,318

SIX-PERCENT CONVERTIBLE SUBORDINATED DEBENTURES DUE DEC. 1, 1979

Date		Par value	Cost
	Purchased from:		
Oct. 15, 1965	Tender offer	993,000	1,918,476
Feb. 4, 1966	Glore Forgan, Wm. R. Staats Inc	1,000	1,935
	Converted into Great Southwest stock	994,000	1,920,411

BUCKEYE PIPE LINE CO.—PENNSYLVANIA CO.

Date		Shares	Cost
	Purchased from:		
Nov. 29, 1963	Delbay Corp	203,300	$6,037,221
Nov. 13, 1963	Butcher & Sherrerd	1,000	31,848
Nov. 14, 1963	do	1,000	31,973
Nov. 15, 1963	do	6,800	214,943
Do	Pension Trust of Bethlehem Steel Corp	100,000	3,500,000
Nov. 18, 1963	Butcher & Sherrerd	2,900	91,152
Nov. 20, 1963	Glore Forgan, Wm. R. Staats Inc	78,800	2,882,127
Do	Butcher & Sherrerd	900	28,550
Nov. 21, 1963	Glore Forgan, Wm. R. Staats Inc	57,816	2,044,668
Do	Butcher & Sherrerd	2,200	70,065
Do	Provident Mutual Life Ins. Co	54,000	1,890,000
Nov. 22, 1963	Butcher & Sherrerd	300	9,516
Nov. 25, 1963	do	2,200	69,914
Nov. 26, 1963	do	300	9,517
Nov. 27, 1963	do	1,500	47,633
Nov. 29, 1963	do	300	9,630
Dec. 2, 1963	Independence Foundation	30,000	1,050,000
Dec. 3, 1963	Butcher & Sherrerd	4,000	125,945
Dec. 4, 1963	Brown Brothers Harriman & Co	106,680	3,745,938
Do	Goldman, Sachs & Co	34,660	1,217,048
Do	Glore Forgan, Wm. R. Staats Inc	48,304	1,695,438
Dec. 23, 1963	Fiduciary Trust Co	14,000	486,500
Dec. 27, 1963	The First Boston Corp	13,000	451,750
Dec. 31, 1963	Supplemental Pension Plan (P.R.R.)	50,200	1,744,450
Do	The First Boston Corp	21,400	743,650
Jan. 7, 1964	Massachusetts Mutual Life Insurance Co	54,054	1,858,712
July 24, 1964	Issuance by Pennsylvania Co. of its $4\frac{5}{8}$ percent cumulative preferred stock of $100 par value per share to various holders of Buckeye common	1,815,905	70,250,348
	Total	2,706,519	
July 25, 1964	14,000 shares of New Buckeye issued in exchange for 2,706,519 shares of Old Buckeye	14,000	
1965	Cost of surveys and documentary stamps, etc		14,681
	Total	14,000	100,293,217

BUCKEYE PIPE LINE CO.—DELBAY CORPORATION PURCHASES[1]

Date		Shares	Cost
1963	Purchased from:		
Jan. 7	All purchases were made from Glore Forgan, Wm. R. Staats Inc	500	$29,286
Jan. 8	do	19,500	1,144,617
Jan. 9	do	57,600	3,381,022
Feb. 14	do	800	47,284
Feb. 15	do	100	5,920
Mar. 8	do	900	53,266
Mar. 11	do	100	5,895
Mar. 13	do	1,900	112,002
Mar. 15	do	300	17,760
Mar. 19	do	2,700	160,337
Mar. 20	do	100	5,920
Mar. 26	do	1,100	65,644
Apr. 5	do	500	31,476
Apr. 17	do	100	6,345
Apr. 18	do	200	12,691
Apr. 19	do	100	6,345
Apr. 22	do	800	6,345
Apr. 24	do	100	53,816
Apr. 25	do	500	32,778
Apr. 26	do	300	19,336
Apr. 29	do	100	6,420
May 2	do	100	6,445
May 8	do	600	38,672
May 10	do	4,900	315,825
May 20	do	200	12,791
May 23	do	800	50,913
May 28	do	700	22,067
May 31	do	300	9,404
May 23	2 for 1 split	94,900	
June 10	do	900	27,984
June 11	do	100	3,109
June 12	do	1,000	30,842
June 14	do	200	6,118
June 17	do	700	21,138
June 18	do	300	9,027
June 19	do	5,100	154,709
June 20	do	200	6,018
Do	do	500	14,919
July 3	do	1,800	52,652
July 26	do	1,700	50,083
Nov. 29	Sold to Pennsylvania Co	203,300	6,037,221

PENN TOWERS, INC.—PENNSYLVANIA CO.

Dec. 31, 1963	Purchased from: Penn Towers, Inc. shareholders	13,200	$1
Dec. 31, 1964	Sold to: Penn Central Transportation Co. (proceeds, $1)	3,600	
	Total	9,600	1

PENN CENTRAL TRANSPORTATION CO.

	Purchased from:		
Apr. 27, 1961	Penn Towers, Inc	6,000	$1
Dec. 31, 1964	Pennsylvania Co	3,600	
	Total	9,600	1
Dec. 28, 1965	Sold to: Tracco—Gateway, Inc. (proceeds, $1)	9,600	1

EVERGLADES PIPE LINE CO.—BUCKEYE PIPE LINE CO. PURCHASES

July 22, 1957[2]	Purchased from: Original issue of Everglades	1,640	$164,000

[1] An indirect subsidiary of Penn Central Transportation Co.
[2] Incorporated.

Exhibit 11

News From the Pennsylvania Railroad

For Release Friday, July 24, 1964

Acquisition of the Buckeye Pipe Line Company by the Pennsylvania Company, a wholly-owned subsidiary of the Pennsylvania Railroad Company, was completed today, Stuart T. Saunders, chairman of the board of the railroad, and George S. Patterson, president of the pipe line company announced.

Under terms authorized by the shareholders of Buckeye, each share of Buckeye common stock has been converted into 0.385 of a share of a new issue of 4⅝ per cent cumulative preferred stock of Pennsylvania Company, $100 par value. Pennsylvania Company has issued 699,123 shares of the new preferred stock for the 1,805,905 shares of Buckeye stock in the hands of holders other than the Pennsylvania.

The new Pennsylvania Company preferred issue will be traded on the New York Stock Exchange beginning Monday, July 27, and trading in Buckeye stock will be discontinued then.

Buckeye shareholders are being notified in a letter from Mr. Patterson that they should send their Buckeye certificates for exchange to Chemical Bank New York Trust Company in New York, which has been designated the exchange agent.

Acquisition of Buckeye was described by Mr. Saunders as "an important step in a long-range program of diversification" for the railroad. The 7,500-mile pipeline network distributes crude oil and petroleum products in New York, New Jersey, Pennsylvania, Ohio, Michigan, Indiana and Illinois.

The Pennsylvania reported last November that it had purchased about 30 per cent of Buckeye shares, and terms for acquisition of the remaining shares outstanding were announced February 6. The terms were accepted at the Buckeye annual meeting May 6 by 93 per cent of the stock voted. The transaction was approved by the Interstate Commerce Commission on July 16.

At a meeting today to consummate the acquisition, David C. Bevan, chairman of the Finance Committee of the Pennsylvania, reaffirmed that Buckeye will continue to be operated as a separate company with the present management. He and Mr. Saunders recently were elected to Buckeye's eight-member board of directors.

Buckeye reported earnings of $2,346,163 or 87¢ a share on revenues of $14,405,848 for the first six months of 1964. The company has declared 50¢ per share in regular dividends this year plus a final dividend of 16¢ per share payable August 12 to shareholders of record July 23.

Buckeye has announced plans to spend approximately $10.5 million to expand existing pipeline facilities in Pennsylvania.

As of the end of 1963, Buckeye had total assets of $86.4 million, long-term debt of $31.3 million, and reported 1963 earnings of $4.7 million or $1.76 per share after adjustment for a 2 for 1 stock split in May, 1963.

EXHIBIT 12

FROM THE PENNSYLVANIA RAILROAD

For Immediate Release, Wednesday, June 24, 1964

Purchase by the Pennsylvania Company, a subsidiary of the Pennsylvania Railroad, of more than 500,000 shares of stock for controlling interest in the Great Southwest Corporation of Arlington, Texas, was announced today by Stuart T. Saunders, chairman of the board of the Pennsylvania, and Toddie L. Wynne, chairman of the Texas-based diversified real estate development firm.

Great Southwest has 1,078,501 shares outstanding and reported earnings of $1,552,445, or $1.44 a share, on revenues of $13,307,085 for the fiscal year ending last September 30. The Pennsylvania's purchase represents about 50 percent of the stock.

The principal property of Great Southwest is a 6,500-acre industrial park midway between Dallas and Ft. Worth. The company also operates warehousing facilities, a luxury motor hotel and a 115-acre family recreation area featuring "Six Flags Over Texas," a Disneyland-type amusement park.

The chief element in the real estate complex is the Great Southwest Industrial District. Some 819 acres have been fully developed, with another 371 acres partially developed. More than 120 industries, many of them operating nationally, have plants, offices and other facilities in the district.

Plans are well advanced for development of 240 acres as a commercial area for retail shops, including a 100-acre regional shopping center with approximately one million square feet of store space surrounding an air-conditioned mall. The first stage in this project is planned for completion in 1966.

Mr. Saunders said that the stock purchase is being made from a group of stockholders associated with Toddie L. Wynne. In addition to the Wynne interests, one of the group is Rockefeller Center, of New York, holder of 170,851 shares.

Mr. Saunders called the investment "a major step in the Pennsylvania's long-range program of diversification." He expressed confidence in the "exceptional growth potential" of the company.

"We regard the management of Great Southwest as excellent. The leaders have done an outstanding job in building up the company, and we are glad that they will continue to be associated with this enterprise. It will be operated as a separate entity. We do not contemplate making changes in the operating management, although we will have representation on the Board of Directors," Mr. Saunders said.

EXHIBIT 13

GLOBE, FORGAN & CO., INTER-OFFICE MEMORANDUM

FEBRUARY 18, 1964.

To: CJH
Re: Great Southwest Corp.

Dear Mr. Hodge: Enclosed is a copy of the draft of the second part of the letter to the PRR. If they have not already received a copy, it might be worth while enclosing a copy of the aerial photograph of the Dallas-Fort Worth area which I have also enclosed. The Memorandum for Prospective Underwriters which we used in connection with the last public offering might also be helpful. There are copies in your files.

Some aspects of the situation which might be included in your section of the letter could be the experience of the railroad in industrial property management (through its Industrial Development Department); the knowledge of the Pennsy of distribution and transportation methods which are such an important element of the operations of Great Southwest; the ability of the PRR to use its contacts to accelerate the growth of GSC; the strong cash flow position of GSC so that it would not be a drain on the finances of PRR; the stability and growth of GSC operations which could help overcome the cyclical character of the railroad business; and the opportunity to participate in the growth of an area which is expanding at a much faster rate than the operating territory of PRR.

WDS.

We believe that an appropriate vehicle for your initial venture in real estate investment would be the common stock of Great Southwest Corporation (GSC). This company is developing approximately 5,700 acres of land located midway between Dallas and Fort Worth, Texas, about 16 miles from the business center of each city. Since a great deal of background information on GSC is already available to you in the 1963 annual report and prospectus, we will summarize here only the principal elements of the situation which make it appear particularly attractive.

BASIC POLICY

As you know, the prime objective of the company is appreciation in the value of its land and buildings and realization of a higher rate of return on its investment as a result of this appreciation. All elements of the development program are designed to promote these values while retaining ownership of the increasingly valuable real estate. By means of its development program and through emphasis of lease rather than sale transactions, Great Southwest anticipates developing a substantial cash flow without resorting to liquidation of its properties.

LOCATION

The Company's properties are well situated to take advantage of recent growth in the Dallas-Fort Worth area. During the decade from 1950 to 1960 the population of Dallas County increased 54.8% and Tarrant County (Fort Worth) 49.1% while for the United States the increase was only 18.5%. During this period Dallas had the fourth fastest and Fort Worth the ninth fastest growth rates among the 40 largest cities in the county. The population of the two towns in which the company's properties are located, Arlington and Grand Prairie, increased 482.1% (to 44,775 persons) and 108.2% (to 30,386 persons), respectively, during the 1950's. It appears that this growth is continuing at a rapid rate.

The properties are strategically located with regard to transportation facilities. The principal highways connecting Dallas and Fort Worth serve the District. The Chicago, Rock Island & Pacific Railroad and the Texas & Pacific Railway are connected through the property by the Great Southwest Railroad. Greater Southwest International Airport (formerly Amon Carter Field) and Love Field, the principal airports for Fort Worth and Dallas, are located approximately five and 15 miles, respectively, from the center of the company's development.

INDUSTRIAL DEVELOPMENT

The company has made excellent progress in its industrial development program. Industrial lease income has increased from $152,000 in fiscal 1960 (year ended September 30) to $249,000 in fiscal 1961, $396,000 in fiscal 1962 and $639,000 in fiscal 1963. Among the more than 100 present occupants of the industrial district are such well known companies as Armour, Bell Aerospace, Borg-Warner, Container Corporation, Fieldcrest Mills, General Aniline & Film, General Foods, Ling-Temco-Vought, National Cash Register, Sperry Rand, Sun Chemical, U.S. Steel, Westinghouse Electric and Xerox.

RECREATION PARK

The park has been extremely successful in accomplishing the objectives for which it was designed; namely, providing a cash flow to permit accelerated industrial development and creating a large flow of traffic to the property with the attendant advertising value. It is anticipated that this project will hasten development of the commercial aspects of the property.

MANAGEMENT

The management has the broad experience essential to the orderly development of an operation which has become as diverse as that of GSC. Each activity is directed by men of extensive experience who appear to possess the ability to capitalize on the potentials inherent in these well-located properties. The management group combines both youth and experience. None of the principal officers of the company are over 50 years of age.

FINANCIAL

GSC has made substantial progress in its development program. Revenues and earnings in all segments of the Company's operation improved during fiscal 1963. Net income increased from $565,246 ($.53 per share) in fiscal 1962 to $1,562,455 ($1.44 per share) in fiscal 1963. Federal income taxes were not payable in either year as a result of prior years' losses brought forward. Operating cash flow (net income plus depreciation) increased from $1,238,897 ($1.15 per share) in fiscal 1962 to $2,401,503 ($2.23 per share) in fiscal 1963.

At the end of fiscal 1963 the working capital of the company was $3,465,000 compared with a working capital deficit of $22,000 at the end of fiscal 1962. Because of the strong financial position and cash flow of GSC, the company does not anticipate additional external financing in the foreseeable future except for mortgages on newly improved properties. Such improvement mortgages generally are self-sustaining in that lease rentals are more than sufficient to cover the debt service requirements.

CURRENT EVALUATION

The average cost of the land owned by GSC is about $2,000 per acre. Most of this land was purchased in 1956 and is carried on the balance sheet of the company on the basis of its original cost. By the end of fiscal 1963 a total of approximately $20 million had been spent by GSC for the development and improvement of land and the construction of buildings and other facilities thereon.

Based on the original cost of the properties, the September 30, 1963 balance sheet showed a book value per share of stock of $9.93. This included all land under leased buildings, the recreation park, warehouse facilities, the Inn and other completed projects on an original cost basis. Based on the shares outstanding at the end of fiscal 1963, each $1,000 per acre of appreciation in land values which has occured since the original purchase of land at an average cost of $2,000 per acre would result in an addition of approximately $4.50 per share to the underlying equity of the stockholders. This attributes all appreciation to land and assumes no increase in the value of building equities as a result of debt retirements or other means.

As of August 1, 1959, Property Counselors, Inc. of Dallas, Texas conducted appraisals of the property of GSC. The conclusions which they reached were that "the aggregate of the present worth, or discounted use values, i.e., market value" as of August 1, 1959 was in excess of $37 million, or an average of more than $7,000 per acre for the land then owned by the Company. This appraisal developed certain of the "market values" based upon assumed land uses which may or may not be different from those ultimately decided upon. In any case, if the properties of GSC were assumed to be worth $7,000 per acre now, four and one-half years later, this would mean that the underlying value per share of stock would be $9.93 plus $22.50 (reflecting the $5,000 assumed appreciation in land values), or $32.43.

The land owned by GSC undoubtedly has increased substantially in value since 1959 as a result of the company's development efforts. Although it is difficult to determine a precise value for the land without a complete appraisal, current sales activity of the company is revealing. At the present time the minimum price at which non-frontage industrial property in the primary development area is being sold is $17,400 per acre. From commencement of operations to the end of fiscal 1963 the average sales price for industrial land was $18,808 per acre. For fiscal 1963 the average sales price was $21,674 per acre for the 19 transactions that year. Prices have ranged from $7,000 per acre to $85,000 per acre with only three sales made at less than $16,000 per acre. At the present time land owned by investor builders within Great Southwest Industrial District is being offered for sale by them at prices ranging from about $20,000 per acre to $35,000 per acre. Recent sales of land in the immediate vicinity of the Company's properties have been made at prices substantially above the minimum selling price of GSC land.

As a result of the foregoing, we believe that the common stock of Great Southwest is selling at a substantial discount from the value of the underlying properties.

FUTURE POTENTIALS

It appears likely that industrial growth of the Dallas-Fort Worth area will continue in the future at close to its present rate. The economics of regional distribution centers have proven themselves so that the demand for good locations should become even more pressing. Judging from the experience of other industrial districts in Dallas and Fort Worth this improving demand will permit higher prices for land to be sold. Since lease income of GSC is based primarily upon a predetermined rate of return on the retail value of land, any increase in land values will be reflected in the return on new and renegotiated leases of the company.

As mortgages are paid off the company's equity in improvements will be increased. After amortization of a mortgage is completed the company will own outright a building in which it has invested no capital and whose value may be at or near the original cost of the building. At this point GSC may find it advisable to refinance the mortgage in connection with a new or extended lease. Great flexibility exists in the actions which might be taken in view of the circumstances at a particular time.

Fiscal 1964 pre-tax earnings for GSC are expected to exceed those of fiscal 1963 substantially. While it is unlikely that this performance can be continued indefinitely, it does appear that both net income and operating cash flow should progress in an entirely satisfactory manner.

In conclusion, we believe that the properties of Great Southwest are well located and well managed and that the current market evaluation of the company's common stock does not take into consideration either current values or the substantial potentials which are inherent in this situation.

Very truly yours,

WALTER D. SCOTT.

PROFIT AND LOSS PROJECTIONS

[In thousands of dollars]

	1962	1963	1964	1965	1966	1967
Industrial rentals [1]	575	796	1,048	1,348	1,708	2,228
Six Flags [2]	1,270	1,605	1,733	1,837	1,910	1,948
Hotel [3]	(125)	(60)	0	0	0	0
Warehouses [4]	(310)	(60)	150	300	350	350
Sales [5]	835	300	250	250	250	250
Total	2,245	2,581	3,181	3,735	4,218	4,776
GSC costs [6]	1,705	1,873	2,064	2,498	2,771	3,166
Pre-tax net	540	708	1,117	1,237	1,447	1,610
Tax				250	724	805
Net profit	540	708	1,117	987	723	805

[1] Includes lease income from GSW to IIP, Inc., as follows: $152,000 in 1962 and $190,000 from 1963 through 1967; also includes GSC office rental to IIP, Inc. as follows: $23,000 in 1962 and $37,500, 1963–67.

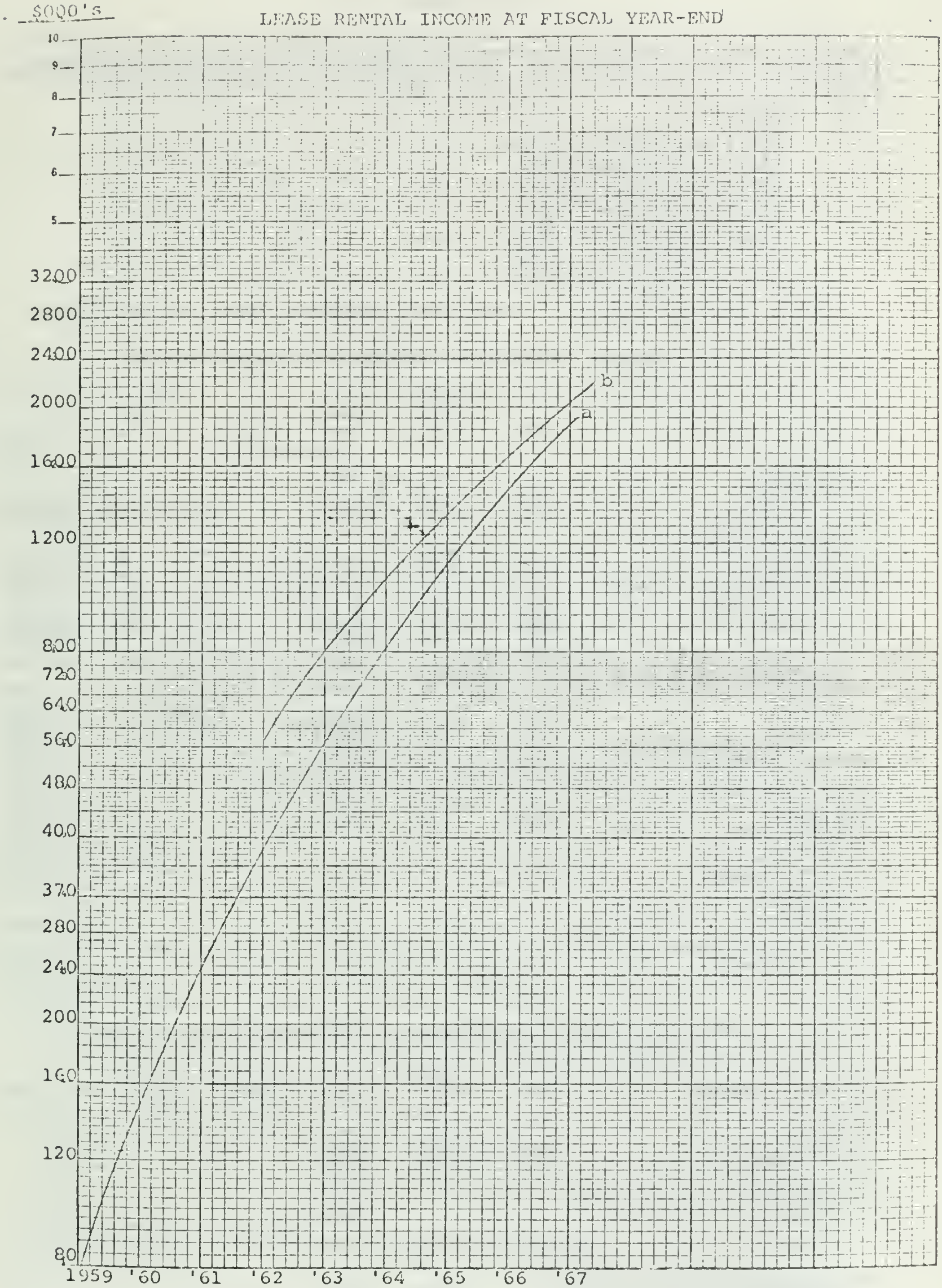
[2] As per estimates of Chas. Thompson based upon 1961–62 actual figures. Assumes increase in price from $2.75–$2.25 to $3.50–$2.50, and increased attendance as follows: 1963=100 percent of 1962; 1964=108 percent of 1963; 1965=106 percent of 1964; 1966=104 percent of 1965; 1967=102 percent of 1966.

[3] Estimates beyond fiscal 1963 indeterminate.

[4] Excludes rental paid to IIP, Inc. (per No. 1 above) and assumes gross revenues of $3,000,000 in 1964 and 1965, $3,500,000 in 1966. and 1967, plus a 5 percent pre-tax profit margin in 1964 and 10 percent 1965–67.

[5] Gross profit after deducting cost of land and/or buildings sold.

[6] Includes office rent of $23,000 in 1962 and $37,500 1963–67 (per No. 1 above) and assumes a per annum amount to cover additional interest, depreciation, insurance, taxes, salaries and wages, etc., equal to 76 percent of the annual lease income increase.


$000's
LEASE RENTAL INCOME AT FISCAL YEAR-END
3200
2800
2400
2000
1600
1200
800
720
640
560
480
400
370
280
240
200
160
120
80
1959
'60
'61
'62
'63
'64
'65
'66
'67
a
b

EXPLANATION OF CHART

Curve "a" plots actual lease income as of September 30th of each year, 1958 through 1962, and estimated amounts 1963 through 1967. This curve does *not* include intercompany transactions, such as rent from GSW and GSC to IIP, Inc. Of $175,000 in 1962 and $227,500 1963–67. Curve "a" indicates the following (in $000's).

1958—40
1959—84 an increase of 110%
1960—152 an increase of 81%
1961—248 an increase of 63%
1962—400 an increase of 61%
1963—568 an increase of 42%
1964—820 an increase of 44%
1965—1,120 an increase of 37%
1966—1,480 an increase of 32%
1967—2,000 an increase of 35%

Curve "b" plots the addition of intercompany rents from 1962–67. For instance, 1962—575; 1963—796; 1964—1,048, etc.

GREAT SOUTHWEST CORP., ANALYSIS OF DISCOUNTED PRESENT VALUES, AS OF SEPT. 30, 1962

Land acquired prior to:	Acres	Market value acre	Market value	Discount	Discount value acre	Total
North property:						
Fully developed:						
Frontage	49.6	$30,000	$1,488,000	⅓	$20,000	$9,920,000
Nonfrontage	185.6	17,400	3,229,440	⅓	12,000	2,227,200
Not fully developed, but in present development program:						
Frontage	114.6	27,500	3,151,500	½	13,750	1,575,750
Nonfrontage	508.4	14,900	7,575,160	½	7,450	3,787,580
Not fully developed and in future development program:						
Frontage	82.1	15,000	1,231,500	½	7,500	615,750
Nonfrontage	1,190.75	12,000	14,289,000	½	6,000	7,144,500
Total	2,131.06		30,964,600			16,342,780
Less applicable purchase money mortgage			282,193			282,193
Total	2,131.06		30,682,407			16,060,587
6 flags land	105.	20,000	2,100,000	½	10,000	1,050,000
Improvements at 80 percent			4,000,000			3,200,000
Value of leaseholds	298.61	1,000	298,610			298,610
Total north property			37,081,017			20,609,197
South property	1,906.65	3,500	6,673,275	⅓	2,334	4,450,121
Less applicable purchase money mortgages						222,869
Total south property	1,906.65		6,673,275			4,227,252
Value of Equities:						
Leased land and buildings at 50 percent			2,600,000			1,300,000
Total valuation of property under the indenture			46,354,292			26,136,449

GREAT SOUTHWEST CORP., ANALYSIS OF DISCOUNTED PRESENT VALUES, AS OF SEPT. 30, 1962

Land acquired subsequent to	Acres	Market value acre	Market value	Discount	Discount value acre	Total
North property:						
Not fully developed	106.92	$8,000	$855,360	⅓		
Partially subject to overflow	436.94	1,500	655,410	⅓		
Total			1,510,770			
Less applicable purchase. Money mortgages			777,716			
Total	543.86		733,054			
South property:						
Not fully developed	74.6	7,500	559,500	⅓		
Less applicable purchase. Money mortgages			126,660			
Total	74.6		435,840			
Total valuation land acquired subsequent to	618.46		1,165,894			

EXHIBIT 14

[Minutes—N.Y.C. Board of Directors meeting, May 4, 1966]

Board of Directors, Wednesday, May 4, 1966; the Chairman presented the following

Cash statement as of April 30, 1966;

Final operating results for the Quarter ended March 31, 1966, compared with the same period of last year;

Income statement for the three months ended March 31, 1966, compared with the same period of last year;

General balance sheet as of March 31, 1966;

Freight traffic situation for New York Central Railroad Company and Leased Lines for the week ended April 30, 1966;

Freight traffic situation for Pittsburgh and Lake Erie Railroad Company for the week ended April 30, 1966; and

Memorandum of Cars Loaded and Received during April 1966, compared with April, 1965;

which statements were placed on file.

A general discussion of the affairs of the Company ensued.

The President asked Mr. Isaac Grainger to report for the Committee appointed at the meeting on March 10, 1966 to investigate the request by The Pennsylvania Railroad Company that this Board consent to an anticipated increase in the aggregate debt of the Pennsylvania Group of companies. Mr. Grainger read the report of the Committee, consisting of Messrs. Grainger, Graham and Odell. A copy of the report was submitted for, and is filed as part of, the minutes of this meeting.

Under the terms of the merger agreement between Pennsylvania Railroad and New York Central, neither company could increase its group indebtedness more than $100,000,000 above the December 31, 1961 base without approval of the directors of the other railroad. On March 2, 1966, Pennsylvania advised that their new indebtedness was not in excess of $100,000,000 but that their group requirements would cause an increase of approximately $100,000,000 above the allowance and requested the New York Central board to approve this increase (now revised to $95,000,000). Such request was submitted to the New York Central board on March 10, 1966, and a Committee composed of directors Graham, Odell, and Grainger was appointed to consider the appropriateness of the proposal and recommend to the board a course of action.

There were only three areas for the Committee's consideration:

I. Composition of the group indebtedness above the merger limitations. Schedule attached.

II. The major causes of such increase.

III. The effects of this excess debt incurrence upon the merged system.

The Committee has had a meeting with Chairman Saunders and Finance Committee Chairman Bevan of the Pennsylvania Railroad and has discussed the findings with General Counsel Gray and Vice President-Finance Grant. Since such meeting, the Committee Chairman has conferred a number of times with both Pennsylvania Railroad representatives to gain additional facts as well as to clarify those given at the conference. Investigations have been made to learn more about the new acquisitions by Pennsylvania Company (holding company through which all subsidiaries are held for the Pennsylvania Railroad). Independent opinions were exceedingly favorable for the Buckeye property and for the most part favorable for the real estate acquisitions. However, questions were raised over short-term prospects for the Arvida properties, and there were negative views expressed in connection with the California properties. Therefore, the Committee cannot give a definitive appraisal of the over-all diversification program of the Pennsylvania Company. While there is a feeling that real estate investment at this time would not be the Committee's choice, nevertheless, it has confidence in the judgment of its partners in the merger.

It is the Committee's view that while the unexpected $65,000,000 cash from the sale of the Long Island Railroad may have been put to different use by the New York Central directors, the contemplated borrowings in excess of the merger limitations are not sufficiently significant or adverse to the interests of the merged systems to cause the directors of New York Central to decline the Pennsylvania Railroad's request. To do so would cause a default in the merger agreement with a resulting collapse of the merger on the eve of its consummation. The benefits of consummation far outweigh any possible adverse results from investments made by the Pennsylvania Railroad especially when neither the Railroad nor its wholly-owned subsidiary is responsible for any of the debts incurred through investment acquisitions.

We therefore recommend that the request of the Pennsylvania Railroad be granted.

R. WALTER GRAHAM, Jr.
ROBERT S. ODELL,
ISAAC B. GRAINGER, *Chairman.*

Whereupon, after full discussion, upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLUTION

Whereas, the merger agreement dated January 12, 1962 between this Company and The Pennsylvania Railroad Company (Pennsylvania) provides that neither party, without the consent of the Board of Directors of the others, will permit an increase after December 31, 1961 of more than $100,000,000 in the debt, as defined therein, of the party and its majority-owned subsidiaries (excluding The Long Island R.R. Co., Wabash R. Co., Lehigh Valley R. Co. and Pittsburgh and Lake Erie R. Co.) defined as a Group; and

Whereas, Pennsylvania, since December 31, 1963, has acquired a majority interest in Arvida Corporation, Buckeye Pipeline Corporation, Great Southwest Corporation and Macco Realty Company which, on the date of the acquisition of said majority interest, those subsidiaries and their majority-owned subsidiaries, had debt outstanding as follows and it is estimated by the Pennsylvania that the debt of each will be increased since acquisition as follows:

Company	Debt on acquisition	Anticipated net increase in debt after acquisition
Arvida	$36,514,000	[1] $514,000
Buckeye Pipe Line	35,741,000	21,259,000
Great Southwest Corp	23,045,000	16,955,000
Macco	39,358,000	4,642,000
Total	134,658,000	42,342,000

[1] Decrease.

Whereas, it is estimated that the Pennsylvania Group (other than subsidiaries acquired after December 31, 1961) will increase its debt as defined in the agreement after December 31, 1961 in the amount of $152,735,000 and substantially all of such increase will be the result of expenditures for equipment and other transportation purposes; and

Whereas, the anticipated increase in debt of the Pennsylvania Group other than subsidiaries acquired since December 31, 1961, when considered with the debt owed by such subsidiaries at the time of acquisition and the increase in the subsidiaries' debt anticipated thereafter, will exceed the $100,000,000 limitation provided by said merger agreement; and

Whereas, Pennsylvania has requested the Board of Directors of this Company to consent, as provided in Article X of the merger agreement, to an increase of debt of the Pennsylvania Group.

Now, therefore, it is hereby resolved that, in accordance with Article X of the merger Agreement, dated January 12, 1962, between this Company and The Pennsylvania Railroad Company, this Company hereby consents to an increase in the debt of the Pennsylvania Group, as defined in said Article X, in the amount of $195,077,000 in excess of the aggregate debt of such Group outstanding on December 31, 1961 and outstanding in each subsidiary heretofore acquired since December 31, 1961 on the date of such acquisition.

Mr. Robert S. Odell here left the meeting.

After statements by the Chairman, on motion duly made and seconded, the following resolution was unanimously adopted:

Resolved: That an expenditure of $195,847 of which $119,223 is chargeable to Capital Account, for the replacement of cross ties on the Canada Division during the year 1965, be, and the same hereby is approved.

After statements by the Chairman, the following resolution was, on motion duly made and seconded, unanimously adopted:

EXHIBIT 15

MARCH 29, 1965.

MR. ALAN T. BROWN,
Sales Administrator,
Arvida Realty Sales, Inc., Miami, Fla.

DEAR MR. BROWN: In answer to your letter regarding Mr. and Mrs. David C. Bevan, I am very happy to submit the following information:

I have known Mr. and Mrs. Bevan for twenty years. I am acquainted with their two sons and consider myself a friend of the family. Socially, I would consider them top flight.

As to Mr. Bevan's business affiliations, he is a director of the Pennsylvania Railroad Company and Chairman of the Finance Committee of the Pennsylvania Railroad. He is also a director of several other companies and is considered an outstanding success in the business community.

Very sincerely yours,

CHARLES J. HODGE,
Chairman, Executive Committee.

ARVIDA REALTY SALES, INC.,
Miami, Fla., March 25, 1965.

[Attachment to above letter]

Mr. CHARLES J. HODGE,
Glore, Forgan & Co.,
New York, N.Y.

DEAR MR. HODGE: Mr. and Mrs. David C. Bevan have made application to purchase an apartment in Sabal Point Apartments, a condominium located in Boca Raton, Florida. Arvida Corporation of Miami, Florida, a publicly held corporation, is the sponsor and Arvida Realty Sales, Inc., a wholly owned subsidiary, the the exclusive sales agent.

Mr. & Mrs. Bevan have given your name as a business reference. We would like you to give us, in confidence, specific information relative to character, personal habits, and abilities in regard to compatibility with their social and/or business associates.

We appreciate the information which you may care to furnish concerning Mr. & Mrs. Bevan. We feel sure also that they will appreciate your assistance in this regard. A self-addressed, stamped envelope is enclosed for your use.

Sincerely yours,

ALAN T. BROWN,
Sales Administrator.

EXHIBIT 16

[Attachment to letter below]

Letter from Martha Fonner to C. J. Hodge, Sept. 29, 1965 and attachments

SEPTEMBER 29, 1965.

MR. HODGE: Mr. E. K. Taylor, Six Penn Center Plaza, Room 1138, Philadelphia, Pa., called re: title policy on Sabal Point Apartment. The Commonwealth Title is the parent co. of Louisville Title Insurance Co. He suggested getting standard type of title policy. He is doing this for Dave Bevan. He asked that we send in your policy to him.

M.F.

OCTOBER 5, 1965.

Mr. E. K. TAYLOR,
Legal Division, The Pennsylvania Railroad Co.,
Philadelphia, Pa.

DEAR MR. TAYLOR: Sorry I didn't take care of this sooner, but Mr. Hodge has been up to his neck and I just got around to telling him how nice you were to suggest that you would take care of getting him the standard type of title policy, which you are doing for Mr. Bevan.

Mr. Hodge wishes me to convey his sincere thanks for your efforts on his behalf.

Kind regards.

Sincerely,

MARTHA FONNER,
Secretary to Charles J. Hodge,
Chairman, Executive Committee.

EDWIN K. TAYLOR, Esq.,
Attorney-at-Law,
Philadelphia, Pa.

DEAR MR. TAYLOR: Your letter of October 14th together with Mr. Charles J. Hodge's new title insurance policy covering his Sabal Point Condominium apartment in the amount of $48,795.00 was received this morning in his absence.

Mr. Hodge is very grateful for your kind cooperation and efforts expended by you in his behalf, and I wish to express his thanks.

Kind regards.

Sincerely yours,

MARTHA FONNER,
Secretary to Charles J. Hodge,
Chairman, Executive Committee.

PHILADELPHIA, PA., OCTOBER 14, 1965.

Mr. CHARLES J. HODGE,
Chairman, Executive Committee,
Glore, Forgan, Wm. R. Staats, Inc., New York, N.Y.

DEAR CHARLIE: I enclose your new title insurance policy for your condominium. Commonwealth Land Title Insurance Company controls Louisville Title Insurance Company, which originally issued the policy to you. I am returning to Commonwealth the policy issued to you by Louisville.

Sincerely yours,

EDWIN K. TAYLOR.

EXHIBIT 17

[From files of C. J. Hodge—"Pinnacle Farm Dinner–Cafe-Boat," August 26, 1965]

GLORE, FORGAN, WM. R. STAATS, INC.,
New York, N.Y., July 28, 1965.

Messrs: Bevan; Bevan; Bodman; Cannon; Gerstnecker; Hendrickson; Kling; Sawin; Seward; Stevens; Tiernan.

The 26th of August is the date of the dinner for the Pinnacle Farm and their guests. My turn has finally caught up, and I can find no valid way of getting out of giving the dinner so that I am inviting each of you and one guest to a dinner at Pinnacle Farm on the 26th of August.

The bar opens at 4:00 P.M. in the afternoon.
Inspection tour 4:00 P.M. to 6:00 P.M.
Cocktails 6:00 P.M. to 7:00 P.M.
Dinner 7:00 P.M. to 9:00 P.M.

Will you please advise me at my office of your acceptance, and whether or not you will have a guest.

I might add that I have arranged with Oscar who owns Delmonico's Restaurant in New York to put on a superb dinner.

I certainly hope that all of you can attend.

CHARLIE.

[Attachment to above correspondence]

SILVERFISH

Bevan, D. C. (Dave), Room 1846, 6 Penn Center Plaza, Philadelphia, Pa.
Bevan, T. R. (Tom), Duane, Morris & Heckscher, Land Title Bldg., Broad & Chesnut, Phila., Pa. 19110.
Bodman, W. (Warren), Yarnell, Biddle & Co., 1528 Walnut St., Philadelphia, Pa.
Cannon, F. A. (Bill), 1st Boston Corp., 20 Exchange Place, New York 5, N. Y.
Gerstnecker, W. R. (Bill), Room 1334, 6 Penn Center Plaza, Philadelphia, Pa.
Hendrickson, W. (Bill), Welding Engineers, Box 391, Norristown, Pa.
Hodge, C. J. (Charlie), Glore, Forgan-Wm. R. Staats, 45 Wall St., New York, N.Y.
Kling, V. G. (Vince), 917 Corinthian Ave., Phila., Pa. 19130.
Sawin, B. F. (Ben), Provident National Bank, Broad and Chesnut St., Phila., Pa.
Seward, C. (Carroll), Yarnall, Biddle & Co., 1528 Walnut St. Philadelphia, Pa.
Stevens, L. M. (Larry), Hornblower & Weeks—Hemphill,, Noyes, 1401 Walnut Street, Philadelphia, Pa.
Tiernan, W. F., Jr. (Bill), Franklin Printing Co., Bunting Lane, Primos, Pa.

EXHIBIT 18

HOTEL EXCELSIOR,
Rome, Italy, October 16, 1961.

Mr. DAVID BEVAN,
Financial Vice President,
Pennsylvania Railroad, Phildelphia, Pa.

DEAR DAVE: I hope that you received my cable.

I met with the Union Bank in Zurich and I was quite firm with them. I established that between themselves and the other two banks they control one million three hundred thousand shares.

I explained to them that the management of the Pennsylvania was the best in the East, and that the solution to the railroad picture in the East was one of mergers and not the selling off of assets further related to them. While the New York Central might have sufficient real estate holdings the Pennsylvania had done all they could with their real estate holdings and that their Crown Jewel was the North Western which was valued at about $350,000,000.

I went into some of the possibilities of merger on a confidential basis explaining to them that my firm was in the middle of most of them. I then told to Saacher that whoever had been pumping him full of mis-information obviously could not be a man of any great responsibility, and that, in fact, I could see that this person had no idea of what he was talking about. I further said to him that I would be pleased to have Saacher quote me to this unkown very emphatically, and that I really thought that the Union Bank and the others were handling themselves in a manner which gave no evidence of fundamental knowledge as pertains to the situation.

The upshot of all this was they were very red-faced, and asked me to assure the management that no steps would be taken of any sort until we had met.

I told them that if they wanted representation on the Board of Directors, providing that their representative was not an Investment Banker, they should bring this point to the management and I was sure that the management would give this consideration. I

further stated that the Chairman of the Board and the Financial Vice President would be happy to come to Zurich if the Bank wanted them to do so.

Saacher answered me by saying they would do nothing and that they were happy I had come to see them and to assure you again that no steps would be taken. He further stated that he with one of his associates was coming to New York in the early part of November, and would at that time like to meet with the Pennsylvania management. I said that I would provide a dinner or luncheon wherein this meeting could take place.

To wrap this up it would have been absolutely unnecessary for you and for Jim to have come to Switzerland after my conversation with them. You realize I am sure that with the usual speed we have served your railroad.

In the meantime I am having a very good time except getting a little fat.

With best regards to all.

CHARLIE.

EXHIBIT 19

SCHWEIZERISCHE BANKGESELLSCHAFT,
November 15, 1961.

MR. FRANCIS N. ROSENBAUM,
c/o Messrs. Goodwin, Rosenbaum, Meacham & White,
Counsellors at Law,
Washington, D.C.

DEAR FRANK: I refer to your letter concerning the visit of General Hodge with our Mr. Saager. Mr. Saager wants me to tell you, that the meeting with General Hodge was very short and that it should not be too largely interpreted. Mr. Saager assured General Hodge, that our bank will not participate in a Proxy Fight.

On the other hand we had of course some interest to learn General Hodge's points of view. It is important to know, that Mr. Saager gave no assurances as to the assisting of the present Management of Pennsylvania Railroad, although General Hodge offered the bank a seat in Penna's' Board of Directors.

Mr. Saager has not yet made any plans as to his next visit to the United States.

Sincerely yours

[Signature illegible]

EXHIBIT 20

[From files of C. J. Hodge, Chairman of the Executive Committee, Glore, Forgan, Wm. R. Staats & Co.]

DINNER GIVEN BY J. RUSSELL FORGAN AND CHARLES J. HODGE, THE LINKS CLUB— OCTOBER 30, 1963

Stuart T. Saunders, Chairman, Pa. RR
David C. Bevan, Chairman, Finance Comm., Pa. RR
Herman H. Pevler, President, Norfolk & Western Ry JRF, JFF, CJH
Thomas S. Gates, Morgan Guaranty Trust, 23 Wall Street, N.Y.
Henry C. Alexander, Morgan Guaranty Trust, 23 Wall Street, N.Y.
Wm. H. Moore, Chairman of Board, Bankers Trust Co., 280 Park Ave., N.Y.
Wm. S. Renchard, Pres., Chemical Bank New York Trust, 20 Pine St.
Harold H. Helm, Chairman of the Board, Chemical Bank N.Y. Trust, 20 Pine St.
George D. Woods, Pres., International Bank for Reconstruction & Finance, 1818 H. Street, Washington, D.C. (N.W.)
L. B. Worthington, Pres., U.S. Steel, 71 Broadway, N.Y.
Robert C. Tyson, Chairman, Finance Comm., U.S. Steel, 71 Broadway
Wm. H. Lang, U.S. Steel, 71 Broadway, N.Y.
M. J. Rathbone, Chairman, Standard Oil Company (N.J.) 30 Rockefeller Plaza
John A. Mayer, Pres., Mellon Bank, Mellon Square, Pittsburgh, Pa.
Orville E. Beal, Pres., Prudential Insurance Company, Newark
Dudley Dowell, Pres., N.Y. Life, 51 Madison Avenue
Cecil J. North, Pres., Metropolitan Life, 1 Madison Ave., N.Y.
George P. Jenkins, Fin. V.P., Metropolitan Life Ins. Co., 1 Madson Ave
Eugene A. Schmidt, Jr., V.P. & Treas., Metropolitan Life Ins. Co.
W. Paul Stillman, Chairman & Pres., National State Bk, Newark
Robert A. Love, Brown Brothers Harriman, 59 Wall Street, N.Y.
Walter E. Dennis, Exec. V.P., Chase Manhattan Bk., 1 Chase Manhattan Plaza
Walter W. Wilson, Morgan Stanley & Co., 2 Wall Street, N.Y.
John M. Schiff, Kuhn Loeb & Co., 30 Wall Street, N.Y.
Albert H. Gordon, Chairman, Kidder Peabody & Co., 17 Wall St., N.Y.
James F. Oates, Jr., Chairman & Pres., Equitable Life Assur., 1285 Ave. of Americas, N.Y.
Grant Keehn, Exec. V.P., Equitable Life Assur., 1285 Ave. of Americas, N.Y.
Peter B. Langmuir, V.P., Northwestern Mutual Life Insurance Co., Milwaukee
Chas. Glavin, First Boston Corporation, 15 Broad St., N.Y.
Harold J. Berry, Harriman, Ripley & Co., Inc., 63 Wall St., N.Y.

M. J. Warnock, Pres., Armstrong Cork, Liberty & Charlotte Sts., Lancaster, Pa.
Hobart C. Ramsey, 5 Delbarton Drive, Short Hills, N.J.
George J. Leness, Pres., Merrill Lynch, etc., 70 Pine St., N.Y.
George Leib, Chairman, Blyth & Co. Inc., 14 Wall St., N.Y.
Charles B. Harding, Smith Barney & Co. Inc., 20 Broad St., N.Y. 5
Joseph H. King, Eastman Dillon, Union Securities & Co., 15 Broad St., N.Y.
Frederic H. Brandi, Pres. & Dir., Dillon Read & Co. Inc., 46 William St.
Sidney J. Weinberg, Goldman, Sachs & Co., 20 Broad St., N.Y. 5
Robert Lehman, Lehman Brothers, 1 William St., N.Y.
Edward K. Van Horne, Pres., Stone & Webster Securities Corp., 90 Broad St.
Frederic G. Donner, Chairman, General Motors Corp., 1775 Broadway, N.Y.
John E. Bierwirth, National Distillers
Joseph F. Cullman, III, Pres., Philip Morris, 100 Park Ave., N.Y.
Lewis A. Lapham, Chairman, Bankers Trust Company
George A. Murphy, Chairman, Irving Trust Co., 1 Wall St., N.Y. 5
R. E. McNeill, Jr., President, Manufacturers Hanover Bank, 40 Wall St.
Benjamin J. Sawin, Provident & Trust Savings Bank, Phila., Pa.
Richard K. Paynter, Jr., Chairman, N.Y. Life, 51 Madison Ave., N.Y.

DINNER AT THE LINKS CLUB—OCTOBER 30, 1963, MESSRS. SAUNDERS, BEVAN, PEVLER

Acceptances:

Orville E. Beal, President, Prudential Insurance Company, Newark
Harold J. Berry, Exec. V.P., Harriman, Ripley & Co., Inc., 63 Wall Street
Frederic H. Brandi, Pres. & Dir., Dillon Read & Co. Inc., 46 William St.
Walter E. Dennis, Exec. V.P., Chase Manhattan Bank, 1 Chase Manhattan Pl.
Charles D. Dickey, Chairman, Comm. on Trust Matters, Morgan Guaranty Trust
Dudley Dowell, President, New York Life Insurance Co., 51 Madison Ave.
Charles C. Glavin, V.P., First Boston Corporation, 15 Broad St., N.Y.
Charles B. Harding, Partner, Smith Barney & Co., 20 Broad St., N.Y.
Stewart S. Hawes, President, Blyth & Co., 14 Wall Street, N.Y.
George P. Jenkins, Fin. V.P., Metropolitan Life Insurance Co.
Everett G. Judson, V.P., First National City Bank, New York
Grant Keehn, Exec. V.P., Equitable Life Assurance Co., 1285 Ave. of Amer.
Joseph H. King, Partner, Eastman Dillon, Union Securities & Co., 15 Broad
Lewis A. Lapham, Chairman, Bankers Trust Company
William H. Lang, Adm. V.P. & Treas., U.S. Steel
R. E. McNeill, Jr., President, Manufacturers Hanover Bank, 40 Wall Street
William H. Moore, Chairman of the Board, Bankers Trust Co., 280 Park Ave.
George A. Murphy, Chairman, Irving Trust Co., 1 Wall Street, New York 5
Richard K. Paynter, Jr., Chairman, New York Insurance Co.
William S. Renchard, President, Chemical Bank New York Trust, 20 Pine St., N.Y.
James S. Rockefeller, 399 Park Avenue, New York, Chairman of the Board, First National City Bank
Benjamin F. Sawin, Vice Chairman, Tradesmens Bank & Trust Co., Phila., Pa.
Arthur D. Schulte, Partner, Lehman Brothers, 1 William St., N.Y.
John M. Schiff, Partner, Kuhn Loeb & Co., 30 Wall Street, N.Y.
Eugene A. Schmidt, Jr., V. P. & Treas., Metropolitan Life Insurance Co.
Dale E. Sharp, Vice Chairman, Morgan Guaranty Trust, 23 Wall Street
W. Paul Stillman, Chairman & Pres., National State Bank, Newark
Robert C. Tyson, Chairman, Finance Comm., U.S. Steel, 71 Broadway
Edward K. Van Horne, Pres., Stone & Webster Securities Corp., 90 Broad St.
Sidney J. Weinberg, Partner, Goldman, Sachs & Co., 20 Broad Street, N.Y.
Walter W. Wilson, Partner, Morgan Stanley & Co., 2 Wall Street, New York
L. B. Worthington, President, U.S. Steel, 71 Broadway, New York
Not heard from—Wm. Boyer, Fin. V.P. & Treas., Republic Steel, Cleveland

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EXHIBIT 21

[Letter from files of C. J. Hodge, Chairman of the Executive Committee, Glore, Forgan, Wm. R. Staats & Co.]

APRIL 6, 1965.

Mr. DAVID C. BEVAN,
Chairman of the Finance Committee,
The Pennsylvania Railroad Co., Philadelphia, Pa.

DEAR DAVE: As you know, Stuart Saunders is going to be in Europe, including Spain during part of May, and has kindly called to advise me of this.

Alfonso Manero and I are very anxious to have him meet some of our friends in Europe, and particularly, our friends in Spain. We understand that Stuart will have Mrs. Saunders with him, and perhaps, another couple.

Alfonso has just returned from Spain and we find it necessary that Alfonso and I go to Spain again on approximately the 18th of April, and will remain there for about a week. During Alfonso's recent trip to Spain, our friends, who are of the highest order, indicated that they wish to consult with us on various matters. One of the prime matters they wish to speak of is to expand a manufacturing facility for freight cars in Madrid which is owned by a company called Euskalduna. This company owns one of the largest shipbuilding plants in Bilbao, in addition to the freight car facilities in Madrid. The Spanish people have asked us to recommend to them a company or companies in the United States who can advise them as to the expansion of the manufacturing facilities for freight cars. Both Alfonso and I feel that a conversation between Stuart and the group in Spain (to include Carlos Mendoza, the head of RENFE, which is the government controlled railroad monopoly in Spain) would be a proper platform for the building up of simpático between Stuart, the Pennsylvania and the Spanish. We, therefore, of course, will refrain from speaking to anyone else until you can advise me as to whether Stuart and yourself feel that this would be a desirable move.

There is no question here of requesting financing. Any money required will be available in Spain from the Spanish. This is merely an effort to bring the Spanish closer to the Pennsylvania Railroad.

I wish you would ask Stuart about this and advise me at your earliest opportunity.

Best regards.

Sincerely,

THE PENNSYLVANIA RAILROAD CO.,
Philadelphia, Pa., April 30, 1965.

Mr. CHARLIE J. HODGE,
Chairman of Executive Committee,
Glore, Forgan, William R. Staats, Inc., New York, N.Y.

DEAR CHARLIE: I now find that by reason of some very urgent developments in our Pennsylvania-New York Central merger that I have to postpone my trip to Europe for several months. My present plans are to go to Europe this Fall.

When our plans crystallize, I will let you know, with the hope that we can get together with some of your friends in Spain. Won't you please let your friends in Spain know of this change.

Sincerely,

STUART T. SAUNDERS.

[Telegram]

To: Fieldglow NYK
COR 825
Bruxelles 28 31 1356
Lt Glostaats New York

Charles Hodge dinner November 17th, Saunddrsxx Saunders. Please advise Verhaegen Belgebank if 8:15 possible instead of 9:00. Stop Belgian personalities used to earlier dinner-time regards.

RIK.

[Telegram]

GLORE, FORGAN, WM. R. STAATS, INC.,
November 3, 1965.

To: Verhagen Belgebank Brussels

Re dinner November seventeenth Brussels Saunders stop They will try to make it as close to eight thirty as possible. Attending cocktail party in their honor. Please call them at Hotel am on seventeenth.

FONNER GLOSTAATS.

[Telegram]

OCTOBER 19, 1965.

RIK VERHAGEN: Pursuant to our conversation of this morning with regard to making the necessary arrangements for Mr. and Mrs. Stuart T. Saunders and Mr. and Mrs. A. Paul Funkhauser, I wish to give you the following dates for dinner, around nine o'clock in the evening as they will be attending cocktail parties before having dinner:

Monday, November 15th, Hamburg, Hotel Vier Jahrezeiten, 9–14 Neuer Jungfernstieg.
Wednesday, November 17th, Brussels, Hotel Westbury, 6 Rue Cardinal Mersier.

Thank you very much for your cooperation.

MARTHA FONNER.

HOTEL ACCOMMODATIONS—NOVEMBER, 1965

[Arrival and departure times are approximate, subject to adjustment due to local traffic conditions]

Number of nights	Date of week	Date	Arrive	City	Hotel, telephone number, and address	Depart
3	Tuesday	2	8:30 a.m	London	Claridge's, Brook St., London W. 1., England (Mayfair 8860).	7:45 a.m.
	Wednesday	3				
	Thursday	4				
	Friday	5				
4	Friday	5	12:00 noon	Paris	Plaza Athenee, 25 Avenue Montaigne, Paris 8, France (ELY 85-23).	8:15 a.m.
	Saturday	6				
	Sunday	7				
	Monday	8				
	Tuesday	9				
1	Tuesday	9	11:30 a.m	Luxembourg	Kons Hotel, Avenue D'Alsace, Luxembourg, Luxembourg (40461).	8:15 a.m.
1	Wednesday	10	6:00 p.m	Zurich	Baur Au Lac, 1 Talstrasse, Zurich, Switzerland (23-57-33).	3:00 p.m.
1	Wednesday	10				
1	Thursday	11	5:00 p.m	Venice	Danieli Royal Excelsior, Riva deg Schiavoni, Venice, Italy (26-480).	2:00 p.m.
1	Thursday	11				
	Friday	12				
2	Friday	12	5:00 p.m	Florence	Excelsior Italie Hotel, 3 Piazza Ognissanti, Florence, Italy (29-43-01).	12:00 noon.
	Saturday	13				
	Sunday	14				
2	Sunday	14	3:30 p.m	Hamburg	Vier Jahrezeiten, 9-14 Neuer Jungfernstieg, Hamburg, Germany (34-10-14).	8:30 a.m.
	Monday	15				
	Tuesday	16				
2	Tuesday	16	8:47 p.m	Brussels	Westbury, 6 Rue Cardinal Mersier, Brussels, Belgium, (02/136480).	8:30 a.m.
	Wednesday	17				
	Thursday	18				
1	Thursday	18	12:30 p.m	Milan	Continentale, 7 Via Manzoni, Milan, Italy (807-641).	8:00 a.m.
	Friday	19				
2	Friday	19	5:00 p.m	Cannes	Majestid, Boulevard de la Croisette, Cannes, France (39-17-92).	12:00 p.m.
	Saturday	20				
	Sunday	21				
3	Sunday	21	4:00 p.m	Rome	Hassler Villa Medici Hotel, 6 Piazza Trinita dei Monti, Rome, Italy (67-26-51).	8:30 a.m.
	Monday	22				
	Tuesday	23				
	Wednesday	24				
1	Wednesday	24	2:30 p.m	Madrid	Ritz, Plaza de Lealtad, Madrid 5, Spain (221-28-57).	4:45 p.m.
	Thursday	25				
1	Thursday	25	7:00 p.m	Lisbon	Ritz, Rua Rodrigo da Fonesca, Lisbon, Portugal (68-41-31).	12:00 noon.
	Friday	26				

15th Hamburg dinner.
17th Brussels dinner.
Mr. and Mrs. Stuart T. Saunders, Chairman of Board.
Mr. and Mrs. A. Paul Funkhauser, Vice Pres. Coal & Ore Traffic.

Mr. Gross,
Secy. to Mr. Saunders.

The Pennsylvania Railroad Co.,
Philadelphia, Pa., December 15, 1965.

Mr. Charles J. Hodge,
Glore, Forgan, Wm. R. Staats, Inc.,
New York, N.Y.

Dear General Hodge: This is just a note to tell you how much Rodie and I appreciated the arrangements you made for the Saunders and us on our recent European trip. We had delightful evenings with Dr. Brinckmann and Dr. Wuttke in Hamburg and with the Verhagens in Brussels.

Incidentally, my wife is the daughter of Ed Gamble who tells me he is an old friend of yours. I am under the impression you served together in the OSS during the war.

Next time I am in New York I would like to come by and meet you and thank you personally for your kindnesses.

Sincerely,

A. Paul Funkhauser.

Stuart T. Saunders.
Ardmore, Pa., December 6, 1965.

Mr. Charles J. Hodge,
Glore, Forgan, Wm. R. Staats, Inc.,
New York, N.Y.

Dear Charlie: I thought that you were almost with us on our European trip, as you were so thoughtful in sending us flowers and arranging for us to have dinner with some of your lovely friends. You certainly added a great deal of pleasure to our trip, and we are most grateful.

I hope that some day Dorothy and I will have an opportunity to reciprocate in some measure.

My kindest regards.

Sincerely,

Stuart T. Saunders.

EXHIBIT 22

AUGUST 3, 1964.

Personal and Confidential

Mr. DAVID C. BEVAN,
Chairman, Finance Committee,
The Pennsylvania Railroad Co., Philadelphia, Pa.

DEAR DAVE: Under separate cover I have submitted a bill for our work on The Buckeye Pipeline Company. This bill is for the total amount of $200,000, and is submitted at your request.

In addition to this, you asked me to write you a personal and confidential memorandum citing the details concerned with this deal. I have attempted to set down what I believe to have been the main work formed by Glore, Forgan & Co. in the last eighteen months to two years.

1. As you know, we have been working on pipe line considerations for your Company for the last seven years, which we have been glad to do.

2. Finally, you recognize, I am sure, it was Glore, Forgan & Co. and myself who proposed this acquisition to you.

3. I think that we have performed an excellent job in acquiring the stock of Buckeye from the beginning.

4. You will remember that we arranged the sale of 53,000 shares of Buckeye from the Massachusetts Mutual to yourselves. Due to existing conditions, it was considered unwise to cross it on the New York Stock Exchange and, therefore, we put you in direct contact with the Massachusetts Mutual and the transaction was arranged at a price of 35 less commission, as your cost. At that time it was said that we would be reimbursed for the double commission. You and I realize that to date it has been difficult to do this, so that it has not come about.

5. I had mentioned to you earlier a fee of $200,000. and this, of course, was excluding the commissions which had been paid or were to be paid, and as pointed out above, we were not paid the $38,000. on the Massachusetts Mutual business.

6. We continued our effort of advising you and working for you to include carrying out negotiations with Kuhn Loeb & Co. acting in your behalf and with, in some cases, the management of Buckeye. I am sure you are aware of the amount of money paid Kuhn Loeb by Buckeye for the work done.

I think the above presents, in short form, a rather concise history of this piece of business. The $200,000. includes the $38,000. involved in the Massachusetts Mutual transaction. This amount in my way of thinking is a most reasonable amount of money when one considers the history and the time involved. I believe, personally, that it is on the minimum side as compared with other transactions of this nature.

I hope that you are in accord with this, and look forward to seeing you soon.

Sincerely yours,

CHARLES J. HODGE.

P.S. Enclosed is the schedule of fees of the deals.

AUGUST 3, 1964.

[First draft notes attached to above letter]

1. Have been working on the pipe line situation since 1950.
2. Totally and personally responsible for the suggestions of Buckeye.
3. We think we did an excellent job of buying the stock in the first instance.
4. We arranged a cross of 53,000 shares of stock from Massachusetts Mutual. Due to conditions, it was more convenient for the stock to be purchased by you directly from the Massachusetts Mutual. We arranged this and you paid 35 less 36.50 per 100 shares, as you were going to send us a deed for $38,160.00 covering the two commissions. This has not been done, and while I am sure the intent was to reimburse us in some way, it has been difficult to do so. You realize that we actually paid the salesmen involved.

I had mentioned that a $200,000. fee was what I considered appropriate for the job, excluding the commissions that had been paid or were to be paid.

The effort that we have put out in attempting to secure stockholders' approval, including work done with Kuhn Loeb is also included. You are aware of what Kuhn Loeb charged Buckeye for practically a week's work.

To sum it all up, we brought you this deal and continued to advise you in all factors relating to acquisition and we succeeded in getting a block of stock and we entered into the final negotiations as your adviser, this over a period of almost two years.

I feel that a bill of $200,000, to include the $38,160.00 commissions due us is a very reasonable bill for the work accomplished.

CHARLES J. HODGE.

[Attachment]

AUGUST 3, 1964.

PENNSYLVANIA CO.,
Wilmington, Del.

For financial advice and other services rendered in connection with the acquisition of the Buckeye Pipe Line Co.. $200,000.00

AUGUST 21, 1964.

Mr. DAVID C. BEVAN,
Chairman of the Finance Committee,
The Pennsylvania Railroad Co.,
Philadelphia, Pa.

DEAR DAVE: I am submitting the list of merger fees, as requested by you. I have included the Pennsylvania-Buckeye as suggested.

I am also submitting a new bill, breaking the $200,000 into its proper factors.

I look forward to the Florida trip with you. See you soon.

Sincerely,

CHARLES J. HODGE.

AUGUST 3, 1964.

PENNSYLVANIA CO.
Wilmington, Del.

For financial advice and other services rendered in connection with the acquisition of the Buckeye Pipe Line Co	$162,000.00
Commissions due in connection with purchase of 53,000 shares of the Buckeye Pipe Line Co. common stock from Massachusetts Mutual Life Insurance Co	38,000.00
Total	200,000.00

MERGER FEES

Company	Banker	Amount	Fees	Percent
Crown Zellerbach, Gaylord Container	Blyth & Co	$123,000,000	$280,000	0.227
Continental Can Co., Hazel Atlas Glass Co	Goldman, Sachs & Co	49,000,000	[1] 250,000	.561
Whirlpool, Delaware Appliance	Goldman, Sachs & Co., Fulton, Reid	40,000,000	100,000	.25
Pabco, Fiberboard Products	Blyth & Co	38,000,000	175,000	.46
Cerro de Pasco, Consolidated Copper Mines	Smith, Barney & Co., Morgan Stanley & Co.	35,000,000	350,000	1.00
Diamond Match (Diamond National), General Packaging.	Morgan Stanely & Co	30,000,000	200,000	.667
Flintkote, Calaveros Cement	Glore, Forgan & Co	30,000,000	450,000	1.5
Ideal Cement, Volunteer Portland Cement	Kidder, Peabody & Co	22,000,000	334,000	1.52
Material Service, General Dynamics	Lehman Brothers-Blyth & Co	100,000,000	260,000	.26
Electric Storage Batteries, Ray-O-Vac	Smith, Barney & Co	17,000,000	125,000	.735
Miehle-Goss Dexter Inc	do	14,000,000	100,000	.714
Average				.718
Pennsylvania Co., Buckeye Pipe Line	Glore, Forgan & Co	70,000,000	162,000	.231

[1] Plus $29,000 financing fee.

EXHIBIT 23

SEPTEMBER 28, 1964.

[Memorandum from D. C. Bevan, Chairman of the Finance Committee, P.R.R. to S. T. Saunders, Chairman of the Board, P.R.R.]

Personal and Confidential
Re: Buckeye

At the present time, we have 2 investment bankers on the board of Buckeye, Bob Brown, semi-retired partner of Kuhn, Loeb and Bob Gardner, partner of Reynolds & Co. Bob Brown, at this point, does not add much either to the prestige or the working knowledge of the board, but in view of his previous importance at Kuhn, Loeb and the fact that he is an extremely high type person, I would hesitate to remove him at this time. I would guess that in 2 or 3 years he would quit of his own accord.

Bob Gardner is a personal friend of George Patterson and to my mind adds nothing to the board from the standpoint of knowledge or prestige. There were also a number of unconfirmed rumors around that he profited very heavily on buying Buckeye stock prior to our acquisition. I would strongly recommend that we replace him with Charles Hodge who brought us the Buckeye business, who has a very substantial background in pipe lines, knows the business well and should be placed in a position to handle the financing of Long Island Pipe Line next year. Everyone in the financial world knows that he brought us this business and the more we show that we stick with the people who bring us business the more favorable deals we are likely to have brought our way.

If you approve, I will be glad to work this out with George Patterson.

JULY 19, 1965.

[Memorandum from D. C. Bevan, Chairman of the Finance Committee, P.R.R. to S. T. Saunders. Chairman of the Board, P.R.R.]

Personal and Confidential

Subject: Arvida Corporation.

Arvida Corporation will have a meeting on July 26th. They can't hold it before because to accomplish some of the things need ten out of twelve members. We will have to caution all members of the Executive Committee to be extremely careful until that time.

Their by-laws call for fifteen directors, they have twelve. They have offered to reduce the number to ten to allow us to put five on if this is satisfactory to you. I think it would be a good first step.

My recommendations as to nominees would be as follows: S. T. Saunders; D. C. Bevan; C. J. Hodge; W. R. Gerstnecker; and Angus Wynne.

I think Hodge should be a member of the board. He brought us the deal, knows a lot about the company and from time to time we will need the advice of a good investment banker who is familiar with the situation.

I feel W. R. Gerstnecker should be included to provide the necessary continuity in the supervision of our investment. This is in line with the duties and responsibilities I have recommended that he should ultimately have.

As our top real estate expert I recommend Angus Wynne. His advice should be invaluable after he gets a feel of the Florida situation.

I believe our directors should be elected at the July 26th meeting. Is this satisfactory with you?

D. C. B.

EXHIBIT 24

WILLIAM R. STAATS & CO., INC.,
Los Angeles, August 4, 1965.

To: Charles J. Hodge

I received Tom Mann's memo of July 25 advising us of the purchase by Pennsylvania Railroad of 51 per cent of the interest in Arvida. I was talking with Maury Sunday and he mentioned just what this meant to the firm in dollars and cents.

Congratulations, Charlie, on the fine piece of business you were responsible for.

I won't be seeing you at the Director's meeting since I will be with my family in Hawaii, however, I look forward to talking with you when I am in New York sometime in October.

R. W. G.

/gv
cc: MHS, PSN

GLORE, FORGAN, WM. R. STAATS, INC.,
Los Angeles, July 30, 1965.

MR. CHARLES HODGE,
New York Office

DEAR CHARLIE: Again I want to congratulate you on the Arvida deal. It certainly comes at a time when we can use the fee and I know what a tremendous amount of work this must have required on your part during the past year.

This will confirm my agreement for you to serve as director of the company.

With best regards, I am

Sincerely,

DONALD ROYCE, Sr.

EXHIBIT 25

[Letter, from files of C. J. Hodge, Chairman of the Executive Committee, Glore, Forgan, Wm. R. Staats & Co.]

AUGUST 19, 1964.

MR. STUART SAUNDERS,
Chairman of the Board,
The Pennsylvania R.R. Co.,
Philadelphia, Pa.

DEAR STUART: I hope this note will convey to you my thanks for a very pleasant evening last night.

I think the turn-out was remarkable and certainly everything was done to the Queen's taste. I particularly wish to thank you for going to the effort, after your small operation, to be present.

I assure you that the group from Texas is of the highest standard. I repeat to you that I have dedicated myself to the service of yourself and to Dave, and to the Pennsylvania in attempting to help you build a real great empire.

Again thanks. I hope to see you soon with a pack of cards in your hand.

Best wishes.

——— ———.

EXHIBIT 26

PARTNERS MEMORANDUM

AUGUST 22, 1958.

Memorandum to Partners

Herbert Herff, who has been introduced to this firm by Clare Kramer, came to J.R.F. with the following proposal:

1. The Great Southwest Development Corporation owns large portions of land on the Turnpike between Ft. Worth and Dallas, Texas.

The Great Southwest is owned by the Wynne, Rockefeller Brothers and certain others.

2. Wynne have decided to extract approximately 150 acres from the property owned by Great Southwest and to construct on this acreage a typical amusement type area which will correspond in many ways to Disneyland.

3. Approximately 150 acres will come in title free as an asset. The Wynne will put $1,000,000 up in cash.

They wish to borrow, for approximately thirty months, $2,750,000. Herff made the deal with them that if he succeeded in getting the $2,750,000, the new subsidiary or amusement corporation would pay back $1,000,000 as a bonus for that $2,750,000 in approximately thirty-six months.

It turns out that this had to be decided quickly and Herff said to me that he was going to take the deal himself unless he could close it by this morning, the 22nd of August.

We have finally agreed Zilkha will lend the money receiving 45% of the bonus as compensation. Herff will receive 45% and Glore, Forgan will receive 10%. All this is to be worked out on a capital gains basis. Each has given his word to the other subject only to the provisions and investigation of the collateral involved.

It is my opinion that Glore, Forgan, for the work of six or seven days, was very fortunate to come out with this amount of money as a profit. It would have been impossible to get any more unless we, ourselves, were willing to commit for a portion of the $2,750,000.

You may consider this a profit which will come in to Glore, Forgan & Co. after the $2,750,000 is paid off, and this profit will be on a capital gains basis.

C. J. H.

[Attachment to above memorandum]

GREAT SOUTHWEST CORPORATION

Great Southwest Corporation now around 15, compared with the original May, 1960 offering price of 18 and a low around 10 bid, merits attention at the present time due to recent developments which are calculated to increase cash flow in the near term and enhance equity values over the years. Thus ownership of the stock enables the holder to participate along with the Wynne and Rockefeller families in the long range development of the Corporation's real estate holdings located approximately midway between Dallas and Fort Worth, Texas, one of the fastest growing areas in the United States. Incidentally the fact is noteworthy that these two dominant groups of stockholders paid an average of about $10 per share for their holdings which comprise about 80% of the 1,037,662 ($1 par) common shares outstanding.

The basic philosophy of the Wynne management is to lease the properties to be devoted to commercial and industrial use, so that prospective increment in the equity, if realized, will inure to the benefit of the stockholders. In order to use the accumulated tax loss and to increase working capital, however, some commercial and industrial land is being sold to "name" buyers at prices which average nearly $17,000 per acre compared with a $6,400 per acre average developed cost for that land. When the residential segment of the District is ready for development, sales of these parcels will be made also.

Recent purchasers:

B-J Service, a Borg-Warner subsidiary which services oil wells, paid about $17,500 per acre for a fixe-acre tract where a regional laboratory and office covering 15.000 square feet has been completed. The new structure houses general offices, sales training and credit operations previously carried on at other locations.

The Frito Company paid approximately $10,000 per acre for a 25-acre parcel: plans call for eventual construction of a processing facility and distribution center to serve the market in the southwest.

National Cash Register has bought for about $22,000 per acre an eight-acre site on which there is to be erected initially a factory covering 40,800 square feet.

In February, 1961 Falvey Container Corporation completed a plant occupying 30,000 square feet of space on its property in the District which the Company says is an ideal location for its operations.

Earlier purchasers mentioned in a previous circular include United States Steel, Container Corporation and Sun Chemical now established in the District.

Unitex Industries which bought property some time ago has had such success with its operations in the District that its facility is being expanded 50% to a total of 75,000 square feet.

Leases entered into include an 80,000 square foot plant for Vought Electronics Division of Chance-Vought Corporation on a 12.5 acre site; a 58,000 square foot diesel engine rebuild facility for Cummins Engine Company and a regional distribution center for Lever Brothers covering 50,000 square feet of warehouse space. The move will represent a departure from Lever Brothers historical practice of maintaining 38 distribution sub-stations in a five-state area. Other tenants are Rich Plan which has moved into a new 10,000 square foot building under lease. Rich is a pioneer in processing and distributing frozen foods. In prospect is an office building occupying 30,000 square feet of land to be built by the Corporation for lease and occupancy by Texas Industries manufactures of concrete building products. Another important tenant is the Ozalid Division of General Aniline and Film Corporation which has a manufacturing plant under lease in the District and which has been operaating since December 15, 1960. General Aniline hopes to expand its facilities in the District in the near future.

While cash flow will increase over the years from various sources the most immediate source of such funds is expected to come from the entertainment center. "Six Flags Over Texas" scheduled for operation in August of this year, just in time to benefit from visitors

to the September Texas State Fair the grounds of which are in the vicinity. This center is planned as a high caliber family show and, according to Mr. Wynne, will be comparable to no other existing entertainment and will feature special attractions including music, good food, and continual activity.

According to an article in The Dallas Times Herald, Sunday Magazine section of February 12, 1961, the principal exhibits will depict the periods of development of the State of Texas under the flags of France, Mexico, Spain, the Confederacy, the Republic of Texas and the United States. Development of the 105-acre tract is expected to cost somewhat less than $4 million excluding the value of the land which is being acquired by the amusement company at cost. The Corporation will hold all the stock of the amusement company. Admission charges will be $2.50 for adults and $2 for children; these entitle the customer to use all the facilities except food for as many times in one day as the patron desires. In view of the low construction cost of the exhibits and the attractive price, very substantial patronage is expected. These rates compare with Freedomland where a separate charge is made for each exhibit and each ride and where it is reported one may readily spend $40 or $50 on only one visit. While Disneyland also charges for each ride separately we understand that the rates are lower than at Freedomland.

Capitalization consists of $9,900,000 of long term debt, and common stock and surplus of about $8,500,000 as of 8/31/60. The apparent book value of around $8.20 per share on the 1,037,662 common shares ($1 par) outstanding 8/31/60 is not indicative of the basic realizable value in the tract, in our opinion. Taking current sales prices of around $20,000 per acre and assuming availability of 3,000 acres for ultimate sale, a gross of about $60 million could conceivably be realized, equivalent, after deducting long term debt, to approximately $48 per share current liquidating value.

Specific data concerning prospective cash flow from real estate operations and the amusement center are expected to be made available soon. When we have the information we shall pass it along to the registered representatives.

We understand that thhe supply of stock "around the street" is drying up as the shares are being placed in strong hands.

For investors interested solely in long term gains without likelihood of current return by way of cash dividend payments, the shares appear to offer considerable attraction at present price levels.

HORNBLOWER & WEEKS,
Underwriting Department.

EXHIBIT 27

FEBRUARY 18, 1969.

MR. KAIER: Won't you please arrange for the preparation of a list of reasons why railroad diversification into other forms of transportation should benefit the public, as requested by Mr. Langdon in the attached copy of his letter to Mr. Saunders, dated February 10.

BASIL COLE.

OFFICE OF VICE PRESIDENT, OPERATION DIVERSIFICATION,
March 10, 1969.

To all department heads:

Jervis Langdon of the Rock Island, pursuant to an assignment from the AAR Board of Directors, has asked Mr. Saunders for reasons why railroad diversification into other modes of transportation would benefit the public.

Attached is a list of reasons suggested by the Legal Department. Won't you please read it and let me have your comments so that Mr. Saunders can respond to Mr. Langdon as quickly as possible.

BASIL COLE.

REASONS WHY TRANSPORTATION DIVERSIFICATION SHOULD BENEFIT THE PUBLIC

1. Shippers will have available a transportation department store where they can satisfy all of their transportation needs instead of dealing with a large number of smaller companies.
2. Transportation costs should be reduced by simplifying interchange between the modes.
3. The containerization of freight will be greatly expedited and facilitated.
4. Tariff simplification should be possible and the quotation of transportation prices made easier.
5. The tracing of shipments requiring transportation by several modes will be easier and more efficient.
6. The broader use of computers and computer programs will be economically sound because of larger universes. This, in turn, will result in greater transportation efficiency and better utilization of equipment.
7. The imbalance of traffic, a chronic problem with the present small transportation companies should be greatly reduced with resulting improvement in equipment utilization and lower transportation costs.
8. By improving all around efficiency and simplifying interchange of traffic, time in transit should be reduced.

9. By funneling traffic to the most efficient means of transportation, much wasteful and excessively expensive use of transportation facilities should be eleminated.

10. The cost of generating traffic, including advertising expenses, should be reduced since sales personnel will be in a position to offer comprehensive transportation service.

11. Some cost savings should be accomplished by reducing executive, legal and overhead expenses.

12. Transportation research should be more extensive and more productive since the emphasis would be upon the best solution to transportation problems in contrast to the present research which is largely channeled along single mode lines.

13. Since the remaining companies offering comprehensive services would have lower costs and greater efficiency, funds would be generated for capital expenditures, thus producing further efficiencies and more effective use of transportation resources.

14. The international movement of freight would be expedited and simplified. Foreign shipping agencies would have all the benefits the domestic shippers would enjoy.

15. Government regulation of transportation would be greatly simplified and expedited since many of the very difficult and complex intermodal problems would be eliminated.

16. Taxation of the diversified companies should be somewhat easier because the difficult problems of maintaining competitive balance by tax adjustments would be eliminated. For example, many user taxes are not imposed because of the intermodal competitive problems they would create.

17. Much discriminatory legislation which results in higher transportation charges could be eliminated. For example, there is a great deal of legislation applicable solely to one mode which results in costs being higher than those of industry generally. A typical example is the Federal Employers Liability Act and the Railroad Retirement Legislation which do not apply to all transportation activities but principally to those of one mode.

18. Many duplicate facilities could be eliminated; freeing land for housing, parks, recreational use, etc.

19. The development of entirely new means of transportation would be stimulated. For example, under the present system which tends to restrict each mode to its own field, there is little incentive to develop entirely new transportation methods and techniques. A railroad has little desire to develop vehicles that will be capable both of operating on the rails and on the highways when it is precluded from operating such vehicles on the highways.

20. By combining companies operating in different fields, opportunities will be afforded management and technical personnel to function in larger universes with a resulting better use of the relatively limited pool of skilled people that presently exists. For example, the manager of a small trucking company has a small field in which to function and produce. In the larger diversified company, his horizons would be broader and his potential productivity increased.

21. The diversified company with its larger resources could work much closer with shippers in solving production problems which are transportation oriented. Too often, under the present system, the individual company's stake in a particular shipper is not large enough to justify an allocation of resources to solve the shipper's production problem. By bringing transportation closer to the production of goods, the public will receive its products faster and cheaper.

22. The movement of agricultural products should be greatly improved with resulting benefits to the farm community and the consuming public.

23. The financing of transportation activities should be improved. Under the present system, many transportation activities present very difficult financing problems because the individual companies are too small and too closely held.

24. Transportation to the smaller communities should be improved. Under today's system with its large number of smaller transportation units, the tendency is to concentrate efforts in the larger metropolitan markets to the exclusion of the smaller communities.

March 25, 1969.

Basil Cole: This refers to your memorandum of March 10, 1969, requesting comments on the list of reasons why railroad diversification into other modes of transportation would benefit the public. We offer the following comment:

First, by way of omission, it is noted there is no reference or inference to modes of transportation other than rail. Also, no mention is made of fulfilling passenger transportation needs. A completely coordinated transportation company should encompass these.

Second, the following might be noteworthy in connection with each of the items listed by the Legal Department:

Item 5—with an efficient transportation system, the necessity of tracing would possibly be eliminated.

Items 6, 7 and 9—relate to improved efficiency. This should produce improved service and this point should be stressed.

Item 10—assumes that advertising and sales expenses would be reduced. This is not necessarily true since stronger companies and increased competition might well increase expenses particularly advertising.

Item 11—might be well to translate "cost savings" to public benefits through more coordinated and effective management.

Item 12—might be expanded to cover public and employee safety research in all modes of transportation to develop the best possible approach: grade closing problems being one example.

Item 17—relating to elimination of discriminatory legislation seems impractical and may be dangerous at this time. Historically, we have been required to retain the legislation, contract or policy which provided the highest benefit to the user or employe.

Item 20—appears an attempt to answer criticism that larger transportation companies would "swallow up" the smaller independents. I would either be silent, or if it is a fact, develop statistics to show that within each mode of transportation the bulk of the business is being handled by a small number of very large companies. This would emphasize the goal of integration of different modes of transportation to give better and more complete service to the shipping public.

Item 21—diversification will not release resources to develop any shippers' "production" problems. It can develop answers to shippers' "distribution" problems. A diversified company can direct its all-encompassing engineering and marketing resources to work much closer with the shipper in solving his distribution problems. The predecessor companies normally recognized their own selfish interests which did not necessarily result in the best distribution system for the shippers.

Item 22—we question the advisability of highlighting one group of commodities to the exclusion of all others.

Item 24—we question the validity of the statement. In retrospect, both the railroads and the airlines made the mistake of offering service to communities in which the market was too small to generate profitable operations.

In addition, integration of the transportation companies should result in more efficient use of our land and air space resources, freeing funds for the economic development of transportation systems for urban areas.

R. G. Flannery.

March 20, 1969.

R. G. Flannery: Yours of March 12 asking for my comments as to why railroad diversification in other modes of transportation would benefit the public:

I believe the reasons cited in Mr. Cole's attachments are generally good.

I have the following comments:

Item 1 implies freight service only. We could mention such things as airlines, busses and car rental businesses which would in addition offer a transportation department store for all transportation needs.

Item 5 implies that tracing all shipments is necessary. With an efficient transportation system conceivably the necessity of tracing would be eliminated.

Items 6, 7 and 9 relate to improved efficiency. This should produce improved service. That point should be stressed.

The assumption that advertising and sales expenses would be reduced may not be valid. With stronger transportation companies and increased competition between the companies, the expenses, particularly advertising, might well increase.

As to Item 11, it might be well to translate "cost savings" to public benefits through more coordinated and effective management.

As to Item 12, this might be expandable to cover public and employee safety research in all modes of transportation to develop the best possible approach; grade closing problems being one example.

Item 17 relating to elimination of discriminatory legislation seems impractical and may be dangerous at this time. Historically, we have been required to retain the legislation, contract or policy which provided the highest benefit to the user or employee.

Item 20 appears an attempt to answer criticism that larger transportation companies would "swallow up" the smaller independents. I would either be silent, or if it is a fact, develop statistics to show that within each mode of transportation the bulk of the business is being handled by a small number of very large companies. This would emphasize the goal of integration of different modes of transportation to give better and more complete service to the shipping public.

As to Item 21, diversification will not release resources to develop any shippers' "production" problems. It can develop answers to shippers' "distribution" problems. A diversified company can direct its all—encompassing engineering and marketing resources to work much closer with the shipper in solving his distribution problems. The predecessor companies normally recognize their own selfish interests which did not necessarily result in the best distribution for the shippers.

I question the advisability in Item 22 of highlighting one group of commodities to the exclusion of all others.

As to Item 24, I question the validity of the statement. In retrospect, both the railroads and the airlines made the mistake of offering service to communities in which the market was too small to generate profitable operation.

In addition, integration of the transportation companies should result in more efficient use of our land and air space resources, freeing funds for the economic development of transportation systems for urban areas.

R. D. Timpany.

March 19, 1969.

R. G. Flannery: In response to your request for comments on the list of reasons why railroad diversification into other modes of transportation would benefit the public, made by Mr. Jervis Langdon (reference your March 12, 1969 footnote to memorandum by Basil Cole, dated March 10, 1969), we have the following to offer:

The basic proposition involved here is that the public would benefit from such diversification in that coordinated transportation service provided by one organization would become available. In general this would facilitate providing the best service most suited to the transportation requirements while reducing the overhead cost burden. It should be noted that this will apply to both freight and passenger transportation needs and to the various modes: rail, air, highway, waterway, or sea.

One omission we note from the list prepared by the Legal Department is any reference or inference to modes of transportation other than rail, such as air, highway, or water. Moreover, no mention is made of fulfilling passenger transportation needs. A completely coordinated transportation company should encompass these.

Suggestions of more minor nature are:

1. The use of a coordinated transportation company would permit the shipper of freight to reduce his traffic staff. This elaborates on the Legal Department's suggestions Nos. 1 and 10.

2. A coordinated transportation company is in a better position to provide more punctual service through its ability to arrange diversions when weather or similar problems interfere with regular routes.

3. As jetports are moved further from the city-centers, and jet aircraft become larger a coordinated air, rail, highway capability as suggested will help solve the problems of space, air pollution and noise harassment.

A. M. SCHOFIELD.

PENN CENTRAL,
March 19, 1969.

R. G. FLANNERY: You requested comments on reasons why railroad diversification into other modes of transportation would benefit the public.

The list which was attached to Basil Cole's memo of March 10 appears to adequately cover all facets of the subject. We have nothing to add.

G. C. VAUGHN.

MARCH 18, 1969.

R. G. FLANNERY: This refers to your notation of March 12th on Basil Cole's memorandum of March 10th regarding reasons why railroad diversification into other modes of transportation would benefit the public.

We concur in the reasons advanced by our Legal Department and have nothing additional to suggest.

E. L. CLAYPOLE.

[From files of A. E. Perlman, President, P.C.T.C.]

Farsighted railroading and fledgling aviation combined at this station 40 years ago today to begin America's first coast-to-coast rail-air passenger service.

On the evening of July 7, 1929, a group of passengers, including Amelia Earhart, embarked from Penn Station on the Pennsylvania Railroad's Airways Limited for Columbus, Ohio. This was the first leg of an exciting new journey by air and rail across the continent.

Forty-eight hours later, they arrived in Los Angeles in a Ford tri-motor plane, piloted by Colonel Charles A. Lindebergh for Transcontinental Air Transport, now Trans World Airlines.

From this beginning, a new era of travel was opened. Within four decades, all corners of our globe have become accessible in a matter of hours.

It was no accident that one of Penn Central's two predecessor lines participated in this historic precedent. Both the Pennsylvania and the New York Central have long believed that railroad companies should offer their customers complete, fully integrated transportation service.

This concept put Penn Central in the vanguard of railroads that formed the Railway Express Agency in 1929, the nation's first organization to encompass all modes of transportation.

The Pennsylvania and the New York Central also played significant roles in the early growth of Greyhound Bus Lines throughout the east.

The New York Central some years ago was active in steamship operations both in the Great Lakes and between New York and Galveston.

The Central, in conjunction with the Flying Tiger Lines, established the first rail-air freight service in this country.

The Pennsylvania entered the petroleum pipeline transportation field in the mid-1960's with its acquisition of Buckeye Pipe Line Company.

More recently, the Penn Central Company made a substantial investment in Executive Jet Aviation, which provides leased aircraft service to many American corporations.

Penn Central is also one of the nation's largest motor carriers, with five wholly owned trucking companies operating over 23,000 miles of certified interstate routes.

We would like to continue such pioneering initiatives into other modes of transport to provide more efficient use of rail-water-air and motor carriers in an integrated transportation scheme.

Unfortunately, the tight regulation of administrative law has kept us from pursuing these objectives more effectively, and we even have been forced to withdraw from some of the ventures entered into over the years.

With the advent of new technology, the age of containerization and major advances in transfer techniques in handling and storage methods, the dead hand of outmoded regulation is denying the American public vast benefits that could be achieved through the growth of true integrated transportation companies.

Each mode of transport has its inherent advantages, but these cannot be utilized to the best interests of the shipping and traveling publics unless they are linked into a coordinated pattern. And the best way to do that, of course, is to permit common ownership of diverse modes of transportation.

In this day of sharply rising demands for increased and improved transportation, it no longer is possible for any single mode to dominate the field. Consequently, anachronistic restraints upon transport diversification, originally erected to curb monopoly, handicap and penalize our entire transportation system, and should be removed.

These barriers were created generally by judicial and administrative bodies and they must be eliminated by action of the legislative and executive branches of government. But such action can be motivated only if the public is aroused to the need for progressive changes. And meanwhile, the United States remains the only nation in the world in which fully integrated transportation companies are not permitted to exist.

On this occasion, we commemorate the combined efforts 40 years ago of two far-sighted companies. Today, however, we live in a much more complex society in which corporations cannot easily undertake such collaboration. And this restrictive situation cannot change without enlightened action by the Congress and administrative agencies in Washington. Progress toward balanced transportation companies calls for the cooperation of many modes of transport, shippers who realize the advantages of common ownership and the public, which will benefit by such a step.

A concerted drive toward this goal would give our nation the efficient transportation network it must have to support its growing needs. The benefit of such a course to our national economy, to America's shippers and to the public at large is an objective worthy of a high national priority.

Exhibit 28

[Attachment to B. Cole Memorandum dated 3/10/69 *supra* (Exhibit 27)]

W.A.L.—

I reviewed the attached and I have one additional suggestion for consideration To quote Mr. Saunders' New York Traffic Club speech of February 20:

"Unless railroads are permitted to diversify into other forms of transportation, within a relative short period of time air cargo will have the same effect on railroad freight traffic as passenger airlines have had on long-haul and intermediate-range railroad passenger service since World War II.

"The impact of airborne freight could be the last straw for railroad freight service except certain bulk commodities, and railroads cannot survive on this sort of traffic alone. This imminent new threat underscores the need for the revision of laws and regulatory practices which prohibit railroads from ownership of other modes of transportation."

This is probably one of the most urgent reasons "why railroad diversification into other modes of transportation would benefit the public."

Bill C.

[William Cunitz, Public Relations Department, P.R.R.]

Exhibit 29

[From files of S. T. Saunders, Chairman of the Board, P.R.R.]

The Pennsylvania Railroad Co.,
Office of the Chairman,
Philadelphia, Pa., January 23, 1967.

Hon. Alan S. Boyd,
Secretary of Transportation, Department of Transportation,
Washington, D.C.

Dear Mr. Secretary: Thank you for your letter of January 14 stating that you would be glad to receive reactions to the points discussed at your Washington meeting on January 5.

I offer the following comments:

Passenger Travel

The Federal Government should, I think, adopt at a fairly early date an overall policy for transporting people. There has been during the past several decades too much emphasis, in my judgment, placed on the highways and airways for mass transportation of people and too little emphasis upon the role that the rails can play, particularly in urban and relatively short-haul, say up to 400 to 500 miles, passenger travel in heavily populated areas.

The 90–10 contribution formula which the Federal government has pursued with reference to highway construction has tended to encourage state and local governments to try to solve their transportation needs too much on the basis of highway transportation. There is growing recognition now that this trend has gone too far and is responsible for much

of the traffic strangulation in many of our cities.

I, of course, know that both highway and air transportation are absolutely indispensable in meeting our transportation needs, but I do feel that too little attention has been given to the role the rails can play. In this connection, I should say that I do not believe there is any future for long-haul rail passenger travel in competition with jet aircraft in high-volume service with great efficiency and economy.

As for urban and short-haul rail passenger travel in congested areas, it has been authoritatively stated that the Government can buy 20 times as much transportation with its tax dollars by upgrading existing rail systems as contrasted with building new highways. And this does not take into account such matters as safety, air pollution, tax losses on property used for highways and airports, loss of industrial sites, and the sheer fact that we are running out of space that can be utilized for these purposes.

I am firmly convinced that contributions on the part of the Federal Government to the development of rail transportation in these respects is a vital public function, one that can produce great economy for the taxpayers and will leave more money to be spent for highways and airports in areas where they can make their greatest contribution to an integrated national transport system.

As for long-haul rail travel, if such travel is deemed necessary in the public interest in the future, the railroads should only be required to furnish it if these losses are absorbed through government support.

In considering this problem, I think consideration should also be given to the policies of the Post Office Department in the handling of mail. Many of that Department's present practices are calculated to reduce rail passenger service or downgrade it.

SAFETY

I believe a careful study should be made to determine whether adequate progress is being made in this field and if not what is deterring the necessary progress. If such study reveals the need for corrective measures, then I think that a joint committee of labor and management should consider the problem with the hope that recommendations could be made as to what should be done.

Many of the statistics in this area may not reflect the true situation and they must be carefully examined, particularly as to the causes of such accidents.

In making such a study, consideration should be given to make-work regulations which are too frequently suggested by labor unions before public service commissions and elsewhere which are not calculated to produce safety but merely to make work.

LABOR-MANAGEMENT RELATIONS

In view of the relatively ambiguous language in the statute creating the Department and the nebulous character of many aspects of this relationship, I do not look upon this as a matter for immediate action except possibly in the field of strikes involving public service industries. I gather, however, that your Department will not directly concern itself with this matter at the present time.

A long-range objective of your Department should be manpower needs and adjustments in connection with technological advances.

DIVERSIFICATION AND COORDINATION

While I feel there will be several years before any great progress can be made in this regard, I think it is absolutely vital that we move toward integrated transportation in this Country as soon and as rapidly as possible. To my mind, this holds the greatest promise of developing a sound, efficient, and economical transportation system for our Nation.

MERGER

I was glad to hear you say that your Department will take an active hand in considering all future merger cases. I would hope that your Department could become the spokesman for the Government in this area. It would certainly produce a broader and sounder consideration of such mergers in light of the public interest and the Nation's transportation needs.

TAXES

I think that your Department should give early consideration to tax policies on both the Federal and state levels which thwart or slow down technological progress or retard the acquisition of the equipment which our transportation industry needs. I have especially in mind the supsension of investment credit and guide lines for accelerated depreciation.

There are numerous instances of discriminatory state and local taxation against railroads. In the development of a sound national transportation system, serious study should be given to this problem.

USER CHARGES

I am sure that your Department will give consideration to this very knotty problem. It is certainly one that requires a high priority. I recognize, of course, that it is permeated with political considerations, but that should not deter an early effort to find some satisfactory solution.

RATE MAKING

While I do not believe your Department should concern itself with ordinary rate problems, I think it should give prompt attention to overall rate-making procedures, particularly

to the end that adequate revenues are produced to enable the transportation industry to earn a reasonable rate on its investments to encourage research and technological improvements.

RESEARCH

As you know, the Federal Government has spent practically no money in this field so far as the railroad industry is concerned. The only major projects in this century are those authorized by the Mass Transportation Act of 1964 and the Research and Development in High-Speed Ground Transportation Act of 1965, and only a small portion of the funds are earmarked for railroad research and development.

The Federal Government has, of course, for many years been spending vast sums for research in connection with highway, air, and water carriers. The time is overdue in my judgment, for the Federal Government to make substantial sums available for research and technology advancement in the rail industry. Such expenditures will pay handsome returns in terms of cheaper and more efficient transportation.

I greatly appreciate this opportunity to express my views on these subjects and, of course, stand ready to assist you in any way that I can in carrying out the terrific responsibilities which you have assumed.

My highest regards, and best wishes for success in your challenging assignment.

Respectfully,

STUART T. SAUNDERS.

THE UNDER SECRETARY OF COMMERCE,
FOR TRANSPORTATION,
Washington, D.C., January 14, 1967.

Mr. STUART T. SAUNDERS,
Chairman of the Board, Pennsylvania Railroad Co.,
Philadelphia, Pa.

DEAR STUART: Your attendance at our Washington meeting was a great help and your fine contribution is deeply appreciated. I hope we can continue to co-operate on this same basis of candor and openness.

Your suggestions on federal aid to rail transportation in congested areas will receive full consideration here.

I would be delighted to receive any additional reactions to the points discussed in our meeting or any suggestions you may have come up with since. Our minds as well as our doors will always be open to you.

Sincerely,

ALAN S. BOYD.

EXHIBIT 30

NEW YORK CENTRAL SYSTEM,
New York, November 23, 1966.

Memorandum for Mr. A. E. Perlman:

I attach a letter dated November 11, 1966, addressed to Mr. Grant from Mr. Martin Bachman, Vice President-Finance, Strick Holding Company, requesting an advance to Strick of $1,100,000, for the purpose of redeeming Strick preferred stock (called for redemption on December 2, 1966) and to repay loans as listed in the letter.

Mr. Grant asked me to arrange to place this item on the agenda for the Central Board meeting on December 8th.

May I have your approval?

R. N. CARROLL,
Secretary.

DECEMBER 1, 1966.

Mr. WALTER R. GRANT,
Vice President-Finance
The New York Central Railroad Co.,
New York, N.Y.

Subject: Requiset for Advance to Strick Holding Co.
Amount of request: $1,897,000.
Date required: December 30, 1966.
Purpose: (Numbers refer to items on list of Cash Requirements).

Nos. 2 and 3: Strick Corp.—Increase in Receivables and Inventory	$1,000,000
No. 5: Transport Pool, Inc.—Equipment Financing	560,000
No. 6: Company owned distributors:	
Universal Transportation	80,000
Rojo Trailer Service	62,000
Trailcon	128,000
U.S. Transportation	67,000
Total	337,000
Grand total	1,897,000

Submitted by: Martin Bachman.
Approved by: W. R. Grant
Funds will be transmitted on December 30, 1966.

JANUARY 4, 1967.

Mr. WALTER R. GRANT,
Vice President-Finance,
The New York Central Railroad Co.,
New York, N.Y.

Subject: Request for Advance to Strick Holding Co.
Amount of request: $2,000,000.
Date required: January 31, 1967.

Purpose: Item No. 1: Strick Finance Co., subordinated loan ------------------ $2,000,000

Submitted by: Martin Bachman.
Approved by W. R. Grant.
Funds will be transmitted on January 31, 1967.

NEW YORK, N.Y., *March 8, 1967.*

Memorandum for Mr. A. E. Perlman:

I attach a letter dated February 10, 1967 addressed to Mr. Grant from Mr. Bachman, Vice President-Finance, Strick Holding Company, requesting an additional advance to Strick of $2,000,000.

Mr. Grant has asked me to arrange to place this item on the agenda for the Central Board Meeting on March 9th.

May I have your approval?

——— ———,
Secretary.

THE NEW YORK CENTRAL RAILROAD CO., BOARD OF DIRECTORS, THURSDAY, MARCH 9, 1967

[Suggested insert for minutes of meeting of Board of Directors]

After statements by the Chairman and the Vice President-Finance and upon motion duly made and seconded and after discussion, the following resolutions were unanimously adopted:

Resolved: That the proper officers of this Company are hereby authorized, in the name and on behalf of this Company, to make additional advances to Strick Holding Company ("Strick") in the aggregate amount of $4,000,000, with interest at the rate of 1% over the prime rate of interest in effect at leading commercial banks in New York City from time to time during the period the advances are outstanding, such funds to be used for the corporate purposes of Strick; and

Further resolved: That any action authorized by the foregoing resolution which shall heretofore have been taken is hereby in all respects ratified, confirmed and approved.

THE NEW YORK CENTRAL RAILROAD CO., BOARD OF DIRECTORS, THURSDAY, APRIL 27, 1967

After statements by the Chairman and the Vice-President-Finance and upon motion duly made and seconded, and after discussion, the following resolutions were unanimously adopted:

Resolved: That the proper officers of this Company are hereby authorized, in the name and on behalf of this Company, to make additional advances to Strick Holding Company ("Strick") in the aggregate amount of $2,000,000, with interest at the rate of one per cent over the prime rate of interest in effect at leading commercial banks in New York City from time to time during the period the advances are outstanding, such funds to be used for the corporate purposes of Strick; and

Further resolved: That any action authorized by the foregoing resolution which shall heretofore have been taken is hereby in all respects ratified, confirmed and approved.

——— ———,
Secretary.

President Perlman
Vice President Grant
Vice President Minor
Comptroller Kappauf
Treasurer McCron
Director of Taxes McEvoy

MARCH 28, 1972.

Mr. WALTER GRANT,
Vice President-Finance, The New York Central Railroad Co.,
New York, N.Y. 10017

Subject: Request for Advance to Strick Holding Co.
Amount of request: $2,000,000
Date Required: $1,000,000 April 1, 1967; $1,000,000 May 15, 1967.

Purpose: Item No. 1: Strick Finance Co. subordinated loan.
Submitted by: Martin Bachman.
Approved by: W. R. Grant.

Funds will be transmitted as follows:

April 1, 1967	$1,000,000
June 1, 1967	1,000,000

MAY 24, 1967.

Mr. WALTER R. GRANT,
Vice President-Finance, The New York Central Railroad Co.,
New York, N.Y. 10017

Subject: Request for Advance to Strick Holding Co.
Amount of request: $440,000.
Date required: July 1, 1967.
Purpose: Item No. 5, Transport Pool Inc., equipment financing.
Submitted by: Marten Bachman.
Approved by: W. R. Grant.

Funds will be transmitted as follows:

July 1, 1967	440,000

NEW YORK CENTRAL SYSTEM,
New York, N.Y., May 29, 1967.

Memorandum for Mr. A. E. Perlman:

Mr. Grant has requested that I place an item on the agenda for the next meeting of the Board of Directors of The New York Central Railroad Company authorizing an advance to Strick Holding Company for $440,000.

May I have your approval?

R. N. CARROLL,
Secretary.

STRICK CORP.,
Fairless Hills, Pa., May 31, 1967.

ULRICH SCHWEITZER, Esquire,
General Corporate Attorney, The New York Central Railroad Co.,
New York, N.Y.

DEAR ULRICH: The government investigator who is looking at Strick's financial condition prior to our being awarded a government contract for some $15,000,000, has insisted that both Strick Holding Company and the New York Central Railroad Co. guarantee the performance of the contract. The guarantees are apparently required because the total of all intangible assets is greater than net worth.

The first of the five copies of the Guaranty Agreement for Corporate Guarantor is filled out as the Government wants it. If the agreement is satisfactory would you please fill out the remaining copies and send four of them back to me.

Also enclosed is a draft of a Board Resolution that is also required.

Speed is essential because the contract award is ready to be made immediately upon receipt of these papers.

I will execute the agreement and have a Board Resolution made for Strick Holding unless you have any objections.

Sincerely,

MARTIN BACHMAN.

[Letter from W. R. Grant, V. Pres. Finance N.Y.C. to S. Katz, President, Strick Corp.]

NEW YORK CENTRAL SYSTEM,
New York, N.Y., May 26, 1967.

Mr. SOL KATZ,
President, Strick Corp.,
Fairless Hills, Pa.

DEAR SOL: This is in reply to your letter of May 25.

I agree with you that your industry has been hard hit by business conditions in the past five or six months, and in times such as these it is difficult to maintain morale and motivate people. However, I think you should know that we have exactly the same problems on Central. One of our largest wage increases in history was forced on us this year, and this is coupled with a sharp downturn in business. Almost daily we are turning down worthy projects offering a good rate of return on Central in the interests of conserving cash during this critical period. At the same time, almost 2,000 people have been released from Central's pay rolls.

Needless to say, this has created for us some very real problems in morale of our employees. This is made doubly difficult when we advance funds to Strick for projects that are not currently showing a rate of return—i.e., both the Finance Company and Transport Pool. I have no doubt that these enterprises will turn around and begin to show a satisfac-

tory profit, but I think you can see the position I am in in attempting to explain this to Central executives.

Now, with respect to the latest request for Transport Pool. At no time during the discussions I had with you and Marty concerning the subordination of our debt in Transport Pool was any indication given to me that you were going to request more funds than were in the original projection given to the New York Central Board, and it was on this basis that I told Marty that we could not exceed the million dollars which we originally agreed to advance for Transport Pool operations. I just have no logical answer to give Central executives who are being refused funds on projects that could be immediately profitable, while advancing funds to Strick. Our cash has dropped some $15 million in the past few months, $9 million of which is in advances to you. I think you must agree that this is evidence of our support during a period when we could ill afford to reduce our cash resources.

As I wrote you earlier this week, if the large Philadelphia Parts Warehouse will require additional advances from Central, this matter should be reviewed at a Strick Board meeting before we proceed. We agree with your statement that these business turn-downs are beyond our control. We are currently in a recession, whether the Administration thinks so or not, and these are problems which we will have to face together. We are just as anxious as your management team is to see Strick prosper, but with our earnings off $10 million in the first four months we are facing a storm that both Central's and Strick's management teams are going to have to weather, even if it means the deferment of many cherished projects.

Sincerely,

WALTER.

[Letter from W. R. Grant, V. Pres. Finance, N.Y.C. to M. Bachman, V. Pres. Finance, Strick Corp.]

NEW YORK CENTRAL SYSTEM,
New York, N.Y., May 25, 1967.

Mr. MARTIN BACHMAN,
Strick Corp.,
Fairless Hills, Pa.

DEAR MARTY: As I advised you by phone yesterday, we cannot approve your request for $1,000,000 for further investment in Transport Pool, Inc.

Your original projection, which we presented to our Board, called for a total of $1,000,000 to be advanced by Central for Transport Pool, of which $560,000 has already been advanced. I am therefore changing this request to $440,000.

At our last Board meeting, I told the Directors there would be no further advances to Strick during 1967, unless there was a large surge in business that required greater investment in receivables and inventories. The whole program of advances as presented to our Board at the time they approved the acquisition of Strick was on the basis that such advances would be made to assist Strick in handling its increased sales volume. With sales volume down, I cannot justify additional advances.

As we discussed yesterday, if the large parts and service center proposed in Philadelphia at a cost of $860,000 will require additional advances from Central, I think we should defer this until the Strick Board can review the matter.

Sincerely yours,

——— ———.

EXHIBIT 31

MAY 6, 1969.

Mr. PERRY M. SHOEMAKER,
Transportation Consultant,
Tampa, Fla.

DEAR PERRY: I enjoyed hearing from you and appreciated your comments about our operations. We have things turned around now, and we look for continued improvement.

You may have missed it in the papers, but the end of last year we disposed of our interest in Strick. The trailers we acquire are being obtained through financing arrangements completed by Dave Bevan. I am told we do not have to put any money down, which helps us at the present time, and they are paid for similar to equipment trusts. In effect, they are ours, and I am advised it is more economical to acquire them in this fashion than to lease this type of equipment.

Mrs. Perlman joins me in sending warm regards to Mrs. Shoemaker and you.

Cordially,

A. E. PERLMAN.

EXHIBIT 32

[From files of S. T. Saunders, Chairman of the Board, P.C.T.C.]

BOARD MEMORANDUM

NEW YORK CITY, WEDNESDAY, APRIL 23, 1969

FIRST QUARTER—1969

Consolidated Earnings for the First Quarter were $4,601,000 or 19 cents per share.[1] New Haven results are included in these figures for the first time. Last year Penn Central reported earnings of $13,388,000 for the first quarter but when restated to reflect the loss of $6.5 million for the New Haven, the comparable figure for 1969 is $6.9 million. On this basis, our earnings were $2.3 million (33.5%) below last year.

Railroad results were far better than some observers have been predicting, despite strikes in the ports and coal fields and continuation of heavy start-up costs in connection with the merger. As you know, the first quarter is historically the low point for railroads in this section of the country,[2] and this year we incurred a deficit of $12.8 million compared with a loss of $5.4 million in the same three months of 1968 (including the New Haven). Last year's results were strongly influenced by gains from two real estate transactions and tax credits amounting to $9.2 million,[3] however, indicating that operating results were much more comparable than these net figures suggest.

New Income Statement.—Many business commentators, analysts and investors continue to judge Penn Central primarily as a railroad despite the fact that only half of our assets are devoted to operations and that our diversified activities produce the preponderance of our earnings. In an effort to overcome this tendency and to portray more accurately the diversified nature of the Company, we have revised the form of the consolidated income statement to accompany the quarterly public release on earnings (See Attachment A, hereto). A copy of this new form is enclosed in the Section of your folder. Formerly we published rather complete revenue and expense detail for the railroad, but only a net income summary on consolidated earnings, with no further breakdown covering subsidiary operations. This new statement presents revenue and expense data for each of our three primary areas of activity—Transportation, Real Estate and Financial—subdivided into the major functional categories.

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[1] 1st quarter results (dollars in thousands):

	1969	1968	Variance	Percent
Railroad PC	($11, 504)	1, 026	(12, 530)	
Railroad NH	(1, 260)	(6, 489)	5, 229	80. 6
Railroad total	(12, 864)	(5, 443)	(7, 321)	(134. 5)
Subsidiaries	17, 365	12, 362	5, 003	40. 5
Consolidated	4, 601	6, 919	(2, 318)	(33. 5)

[2] Going back to 1963, the companies which now comprise Penn Central reported a combined 1st quarter net railway operating deficit in 3 of the last 6 years. Moreover, they had an aggregate 1st quarter deficit of $2,800,000 for those 6 years although, on an annual basis, they produced a total net railway operating income in excess of $223,000,000, as indicated by the following:

	1st quarter	Year
1963	($10, 049)	$39, 843
1964	7, 514	56, 299
1965	5, 639	79, 843
1966	13, 076	100, 615
1967	(9, 199)	(2, 654)
1968	(9, 784)	(51, 208)
6-year total	(2, 802)	222, 733
6-year average	(467)	37, 123

[3] 1st quarter 1968 railroad results included:

Sale of Albany passenger station	$3, 480
Sale of Mott Haven	3, 326
Tax credit adjustment	2, 400
Total	9, 206

One advantage of this new format is that it permits evaluation of each type of activity in the context of the entire enterprise, thus eliminating misimpressions that may be gained when overall results are ignored and undue significance is attributed to individual transactions. For example, the gain or loss resulting from a multi-million dollar sale of property would be regarded as extraordinary to a smaller concern, but not one with revenues from real estate operations of $40–45 million in a single quarter.

This new form of statement is entirely consistent with the concept of the parent Holding Company. It will be necessary to continue reporting to the I.C.C. on the traditional basis for the railroad companies, of course, but absent some unforeseen development, we plan to switch to this new type of statement for the information to be made available to stockholders and the newspapers.

With reference to the Railroad revenue and expense data shown on this statement, the figures are greatly influenced by inclusion of the New Haven in 1969 but not 1968. As I previously indicated, the New Haven lost $6.5 million in the first quarter of last year, which, on a *comparable* basis, brings the 1968 net income down to $6.9 million.

Start-up Costs and Savings.—Merger start-up costs and losses in the first quarter, while not as heavy as in the last half of 1968 [4] had an $8 to $10 million effect on the first quarter results. On the other hand, merger savings were approximately $5.5 million [5] and these will be recurring year after year whereas the costs will not. The greatest impact has been from loss of revenues, which we estimate at $6.5 million as the result of service problems.

Service.—We continue to receive assurances from shippers that our service has improved *markedly* [6] and we are continuing our contact program. Since the last meeting I have personally called on the top executives of Bethlehem Steel, American Car, and other important customers. Carnation Company, U.S. Borax, Kaiser Aluminum, and other major concerns have been covered by our top Traffic and Operating Officers, and Mr. Perlman has just returned from a tour of the West Coast where he talked with many of our off-line shippers at luncheons and dinners in Los Angeles, San Francisco, Portland, Seattle, Dallas and Houston.

Operating Revenues [7]—Considering only Penn Central and New Haven, operating revenues during the first quarter were about $6 million or 1.4% below 1968 (despite the 5% freight rate increase which yielded about $15 million in additional freight revenues) as a result of the following:

Strikes on the docks and in the coal fields adversely affected revenues by approximately $5.1 million.[8]

Weather conditions were unusually mild over most of the System this winter, but record snowstorms in New England cost us about $1 million in revenues.

Mail revenues for the first quarter were down $2 million, or 11.7% from 1968.

Express traffic also continued to erode at an accelerated rate, declining $2.6 million in the quarter, which is a 68% drop from the previous year.

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[4] See Attachment B, hereto, for tabulation of 1968 Merger Start-up costs.

[5] Source of estimated savings in First Quarter 1969—

	Million
Consolidation of offices and fixed facilities	$3.2
Maintenance of Equipment and Roadway	1.7
Train Operations	.6
Total	5.5

[6] Excerpts from letters reproduced on Attachment C, hereto.

[7] Operating revenues (thousands) including New Haven (but excluding D.T. & I., P. & L.E., and other railroad subsidiaries whose revenues are included in the consolidated income statement:

	1st quarter	Variance (from 1968)	Percent
Freight	331,533	(2,931)	(0.9)
Passenger	35,631	1,217	3.5
Mail	14,834	(1,964)	(11.7)
Express	1,265	(2,647)	(67.7)
Other	22,690	372	1.7
Total	405,953	(5,953)	1.4

[8] Strikes:

	Began	Settled	Cost in 1969
Longshoremen's	Dec. 20, 1968	Feb. 25, 1969	$3,000,000
Coal miners' black lung	Feb. 21, 1969	Mar. 11, 1969	1,600,000
Philadelphia ore pier	Sept. 18, 1968	Mar. 9, 1969	200,000
Others	Mar. 3, 1969	Mar. 21, 1969	300,000
			5,100,000

Passenger revenues were about $1.2 million, or 3.5% ahead of last year. The Metroliner operation contributed an estimated $882,000. The continued decline in long-haul passenger service was offset by the 10% interstate fare increase that became effective in March, plus volume gains in commuter operations.

Operating costs for Penn Central, including New Haven[9] were seriously affected by the forces of inflation although we were able to hold them fairly well in line by improvements in productivity and merger savings.

Labor costs in the first quarter were up $7 million due to increased wage rates aggregating 5.5% and higher payroll taxes.[10] However, this figure is $12 million lower than it would have been had it not been for the contraction in our work force of 4,855 employees;[11]

Grand Central Terminal—Tower Building.—It has been reported in the press that we have submitted a new plan for the tower building over Grand Central Terminal. Our first proposal, which was designed to preserve the facade of the station, was rejected last September by the New York Landmarks Preservation Commission. At that time an influential group known as the Urban Design Council spoke out against the scheme and suggested that if there was to be a building it should be built from the ground up.

Adopting that suggestion, our second offering rises from ground level without regard for the facade. However, its design preserves the main concourse, the most important architectural feature of the terminal. Moreover, the plan endeavors to meet complaints regarding further crowding of the area by modernizing and improving the terminal facilities for pedestrian traffic.

Hearings began before the Landmarks Preservation Commission on April 10 and the Tower's creator, Marcel Breuer, presented a statement describing the many advantages of the new design.

While the City Planning Commission immediately repeated its opposition to any construction over Grand Central, we are hopeful that Mayor Lindsay can be persuaded to support the new building. To that end, last week I visited with Mr. W. S. Paley, Chairman of the Urban Design Council to urge his intercession with the Mayor.

PASSENGER—LOSSES AND METROLINER

Our passenger service losses in the first quarter were $26 million as compared with $28.8 million in the same three months of last year. The seriousness of this situation, and the difficulty of making any headway in reducing this deficit, is demonstrated by the fact that rising costs associated with passenger service permitted us to cut our losses by only $2.8 million under the First Quarter of last year, despite train discontinuances and other economies made during 1968, which were projected to produce savings of about $40 million on an annual basis.

Thus far in 1969, we have managed to discontinue 15 intercity passenger trains at an annual savings of $1,092,776. At present we are preparing or have pending applications involving 31 trains and approximately $6.9 million in annual savings. These measures are inadequate in the face of rising costs and loss of long-haul revenues, however, and we have undertaken a study of the potential passenger market for the purpose of restructuring operations so as to improve the service we provide and minimize losses. Tentatively, we believe that we can reduce the number of intercity trains now operated by about 50%, resulting in a reduction of about 5.9 million train miles annually.

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[9] Operating expenses (thousands) including New Haven (but excluding D.T. & I., P. & L.E. and other subsidiaries whose expenses were included in the consolidated income statement):

	1st quarter	Variance	Percent
Operating expenses	338, 897	7, 804	2. 3
Railway taxes	29, 679	456	1. 5
Equipment-Jt. facility Rts	47, 470	(2, 616)	(5. 8)
Total operating costs	416, 046	5, 644	1. 3

[10] Wage rates were increased 3.5 percent on July 1, 1968, and 2 percent on Jan. 1, 1969. Railroad retirement tax rate increased from 8.9 to 9.55 percent on Jan. 1, 1969. Taxes also increased as a result of higher taxable wages due to the wage rate grants.

[11] Employment—1st quarter 1969 (including New Haven):

		Variance from 1968	
	1st quarter	Number	Percent
Average number employees	97, 667	−4, 855	−4. 7
Total labor cost (thousands)	$261, 000	+7, 000	+2. 8

The mid-month count (including New Haven) for March was 98,125 employees, an increase of 438 over Feb. 1969, but 5,200 below Mar. 1968 representing savings of $56,000,000 on an annual basis.

Metroliner Operations.—While we are experiencing equipment problems with our non-stop trains, the Metroliner service, on the whole, is still doing nicely from the standpoint of on-time performance, passenger volume, and public acceptance.

During the period January 16 through April 16, there were a total of 112,955 passengers aboard the six trains, producing revenues of $1,179,705. Based on available seat miles of 23,284,800 for the period, the six trains operated with a 79.4% seat mile utilization factor.

The first four trains have on-time factors exceeding 90%. Unfortunately, the higher speeds of the non-stop schedules have revealed a number of flaws requiring a temporary reduction in Metroliner speed to 110 miles per hour, and thereby preventing the non-stop trains from consistently meeting their schedules. Also, the patronage of the non-stop run which leaves New York at 7:10 A.M. is well below all of the others, including the afternoon return trip from Washington. It may be that the departure time is too early for New York and New Jersey suburban passengers to reach conveniently.

There is still no indication that the Metroliners are having any appreciable adverse effect upon the balance of our passenger service between Washington and New York. Indeed, our survey of the trains immediately preceding and following the Metroliners during the February 1-April 14 period showed an increase of 2.4%, on the average, over 1968 volume.

Our Legal Department has been in touch with the Budd Company concerning the deficiencies in the GE cars we have been operating and conveyed our expectation that the defects will be corrected or appropriate compensation made. Under the terms of the November 1968 Supplemental Agreement, Penn Central retains its right to claim damages for failure to live up to warranties and specifications provided in the original contract with Budd.

We have recently negotiated a contract for the maintenance of component parts manufactured by General Electric. This should prove beneficial during the early stages of this service.

The first six Westinghouse cars have passed a number of performance tests and are now undergoing modifications deemed mandatory for acceptance. We anticipate that these cars will be available around June 1. Upon the completion of the substation modifications about June 15, we hope to have this equipment in service.

Some of you have expressed concern about the ticketing and reservation procedures for the high speed service. To comply with the Department of Transportation's ban on standees, and to satisfy our need for maximum utilization of space, we inaugurated this operation with a manual inventory control system. However, we did not and could not have anticipated the tremendous demand that was to tax the capacity of our passenger sales facilities and occasion the ticketing and reservation difficulties. For a time, we were averaging 1,500 calls for the 308 seats in New York and Washington trains.

When the proportions of the problem became apparent, we immediately instituted corrective measures. By April 2, at New York, Philadelphia and Washington, we had added 14 new telephone lines, 8 telephone clerks and 4 ticket clerks. Recent checks indicate that the delays have been reduced to an acceptable, but not desirable, level. In July we will complete installation of a 200-line automatic call distributor in New York and this will materially improve our reservation and information system. We are giving consideration to direct telephones from hotels, stores, banks and other convenient locations in New York, Philadelphia and Washington.

While our present ticketing method prevents oversale and at the same time maximizes seat utilization, it requires up to ten minutes to process each passenger. We have now contracted for the August installation of a computerized system which will complete the entire reservation ticketing procedure in approximately 20 seconds at all Metroliner stations. The machines at the counters will have available all the accommodations on the Metroliners for a month in advance and as each reservation is sold a seat is selected, removed from the inventory, and a ticket is printed. This will be the most advanced ticketing procedure in use anywhere and we are confident that it will add greatly to the attractiveness and public appeal of the Metroliner service.

Another intriguing aspect of this new system is the potential it has for permitting the passenger to prepare his own ticket.* At the Annual Meeting, we plan to display a vending machine which can sell reserved or coach space directly to the customer.

You will be interested to know, too, that on April 30, Columbia Broadcasting System will film what it calls the Great Race between our non-stop Metroliner and Eastern Airlines' shuttle. Harry Reasoner and a five-man camera crew will ride our train and Mike Wallace will ride the plane. They will start from CBS offices in New York at the same time and meet at The White House for lunch. In previous races the shuttle reporter has beaten the Metroliner reporter but we have received favorable publicity about the comfort and reliability of our service.

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*By computer-connected "vending machines" to be located in hotel lobbies, banks and other convenient locations.

PENN CENTRAL CO. AND CONSOLIDATED SUBSIDIARIES CONSOLIDATED INCOME STATEMENT, 3 MONTHS ENDED MAR. 31, 1969, AND 1968

[In thousands of dollars]

	New Haven (included in 1969)	1st quarter 1969	1st quarter 1968	New Haven (not included in 1968)
Revenues:				
Transportation operations:				
Railroad		441,872	411,535	
Pipeline		9,399	9,383	
Trucking and Warehousing		24,612	18,525	
Total	30,218	475,885	439,443	29,725
Real estate and other operations:				
Sales of properties		22,463	22,263	
Hotels, apartments, clubs, and parks		13,136	12,905	
Rents, royalties, and other		9,582	6,720	
Total	1,030	45,181	41,888	1,831
Financial operations:				
Dividend and interest		8,741	8,410	
Gain on securities transactions		6,725	4,720	
Total	918	15,466	13,130	
Total revenues	32,166	536,539	494,461	31,556
Costs and expenses:				
Transportation operations:				
Railroad		448,643	408,963	
Pipeline		4,792	4,859	
Trucking and warehousing		19,512	17,977	
Total		472,947	431,799	
Real estate and other operations:				
Cost of properties sold		12,499	9,275	
Other costs		13,653	12,640	
Total		26,152	21,915	
Total costs and expenses	33,000	499,099	453,714	36,577
Income before fixed and other charges	(834)	37,431	40,747	(5,021)
Fixed and other charges:				
Interest on debt		29,512	23,822	
Federal income taxes		645	1,391	
Income applicable to minority interests		2,673	2,538	
Equity in income from subsidiaries disposed of			(392)	
Total	426	32,830	27,359	1,448
Ordinary income for the year	(1,260)	4,601	13,388	(6,469)

Note: Penn Central Co. consolidated income statement includes all subsidiaries owned over 50 percent except Wabash Railroad and Lehigh Valley Railroad, for which disposition has been or is to be arranged. Add note on effect of New Haven loss of $6,469,000 in 1968—$6,918,000 income.

PENN CENTRAL CO. MERGER "START UP" COSTS AND SAVINGS YEAR 1968

	Amounts reflected in Income account	Amounts reflected in Reserve	Amounts reflected in Capital	Total
Costs:				
Personnel:				
Separation payments	$4,289,939	$12,720,210		$17,010,149
Protection payments	1,900,000	9,382,296		11,282,296
Transfer and relocation	1,840,698			1,840,698
Train and engine pilot training	400,000			400,000
Overtime in excess of normal levels	15,000,000			15,000,000
Interim pension payments	358,996			358,996
Cost of employee homes			$1,206,000	1,206,000
Total personnel costs	23,789,633	22,102,506	1,206,000	47,098,139

PENN CENTRAL CO. MERGER "START UP" COSTS AND SAVINGS YEAR 1968—Continued

	Amounts reflected in — Income account	Reserve	Capital	Total
Properties:				
A. E. Perlman Yard 1968			19,864,767	19,864,767
A. E. Perlman Yard Prior			12,606,612	12,606,612
Buffalo Lock Haven CTC			2,776,053	2,776,053
Seneca Yard	8,597		2,052,158	2,060,755
Columbus Yard			1,897,783	1,897,783
Indianapolis Big 4 Yard	37,918		1,561,017	1,598,935
All other	412,545	1,589,282	3,213,216	5,215,043
Total projects	459,060	1,589,282	43,971,606	46,019,948
Penn Central equipment conversion	2,147,400			2,147,400
Additional multilevel per diem costs	15,000,000			15,000,000
Total costs	41,396,093	23,691,788	45,177,606	110,265,487
Revenue losses	33,460,000			33,460,000
Penn Central "start up costs"	74,856,093	23,691,788	45,177,606	143,725,487
New Haven advances			14,000,000	14,000,000
Total including New Haven	74,856,093	23,691,788	59,177,606	157,725,487
Savings:				
Elimination and consolidation of fixed facilities	12,654,348			
Maintenance of equipment	6,190,711			
Maintenance of roadway	777,793			
Property taxes and insurance	292,000			
Train operations	2,577,500			
Total savings	22,492,352			
Effect on earnings	(52,363,741)			

Service.—We are still receiving assurances from shippers that our service has improved. For example, a vice president of Peavy Company wrote one of our executive vice presidents[1] as follows:

"We have, as you know, complained heatedly about service in shipping grain products from Buffalo over the past several months, and I think that you would agree there was good reason for us to do so.

"I am very happy, however, to be able to say that conditions apparently have improved remarkably in the past few weeks. We hope that the improvement will continue.

"We certainly do appreciate what has been done."

The president of Illinois Cereal Mills wrote Mr. Perlman[2] that—

"It is with pleasure that we go on record with you and your associates that there has been an 'improvement' in our service.

"We have been able to get one of our national accounts who was complaining at that time, to given Penn Central the long end of the haul."

An appliance dealer[3] serving the Buffalo—Rochester area wrote—

"I think it only fair to advise you that since that date (February 26) our life with Penn Central has taken on a new and pleasant phase. Deliveries have improved to a point I would consider quite normal."

"The latest article in Forbes Magazine relative to your company may well have been written prior to your new lease on life."

EXHIBIT 33

[Memorandum from files of D. C. Bevan, Chairman of Finance Committee, P.R.R. to S. T. Saunders, Chairman of Board, P.R.R.]

FEBRUARY 15, 1965.

S. T. S.: We can do a better job of presenting both our full earnings and our financial position to stockholders, financial analysts and investors by extending the consolidated financial statements to include all majority-owned subsidiaries which we control. To do this we would consolidate, for statement purposes, virtually all companies in which our interest exceeds 50%. Exceptions would be limited to companies we do not control, such as Long Island Rail Road, or companies whose control is temporary, such as Wabash.

The important change from our present reporting is the including of P.R.R. stockholder share of undistributed earnings of the majority owned and controlled companies. These earnings are now shown, in part, in the notes to the financial statements but they are not in the consolidated income and balance sheet figures. The change can become even more significant as we proceed with further corporate acquisitions, such as Great Southwest.

Producing consolidated financial statements for the whole of our interests is a major undertaking. It requires consideration of 20 additional companies, analysis of all pertinent accounts and restatement of data reported for the past four years.

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[1] Letter dated April 3 from S. R. Scoggin to H. W. Large.
[2] Letter dated March 31 from W. F. McRae.
[3] Letter dated March 28 from I. H. Block, W. Bergman Company to H. W. Large. February 15, 1965 and [from files of D. C. Bevan, Chairman of Finance Committee, P.R.R.]

The character of the problems presented, mostly technical accounting in nature, is reflected in the attached outline of operations my accounting people have prepared.

The best way to approach this problem is to do the staffing for the job ourselves. This is clearly the least costly course for us to take and, accompanied by periodic review with independent accountants, will produce the answers we seek. The approach also affords a means for our obtaining a skilled staff of technically competent people from which we can draw our later requirements.

The accountants estimate a one-time requirement of approximately ten man-years of work on our part to get this done. We can get about half this effort from people now with the Company. The other half would be obtained by hiring young but experienced C.P.A.'s who would meet the long-term needs we recognize. Professional opinion required by the task would probably cost us $50,000. This, plus our own payroll would put the total cost at $175,000. When the initial work is done, keeping the consolidation current, and providing a technically equipped staff for merger and acquisition accounting will require about four people.

In view of the complex character of the problem, the need for orderly staffing and review, together with my insistence on careful evaluation of the implications of each of the moves, I have concluded it is impractical to target on such a basic change during this year. Instead, our aim is to be in a position to issue fully consolidated stockholders' statements for the whole year 1965 and for subsequent quarterly periods.

D. C. B.

PHILADELPHIA, PA., *February 26, 1965.*

D. C. B.: I approve the program outlined in your letter of the 15th with reference to consolidated financial statements to include all majority-owned subsidiaries which we control.

You will, of course, see that this program is carried out.

STUART T. SAUNDERS

EXHIBIT 34

CHICAGO, ROCK ISLAND AND PACIFIC RAILROAD CO.,
Chicago, Ill., May 26, 1969.

Mr. STUART T. SAUNDERS,
Chairman of the Board, Penn Central,
Philadelphia, Pa.

DEAR STUART: At Friday's AAR Board meeting you asked me for a copy of the remarks I made on the subject of diversification for railroads into nontransportation fields at a recent dinner of the Minneapolis Traffic Club. I am sending you a copy herewith.

I appreciate that my "logic" and conclusion have been challenged by at least one railroad president, and undoubtedly there are others who would disagree.

In summary, my point is this: Railroads, unlike other corporate undertakings, *must* work together if their public service obligations are to be discharged satisfactorily, and yet for forty years at least, they have been unable to agree on such vital issues at (1) rationalization of the industry through merger, (2) terms to govern the establishment and operation of an adequate national car pool, with through service routes and rates, (3) research programs designed to point the way for the full development of the rail form of transportation, etc., etc., etc.

Why has this been so? The answer seems to be that individual railroads have been run primarily for the assumed benefit of stockholders, with the result that they have not felt free (particularly the fortunately situated ones) to make the adjustments necessary to formulate balanced railroad systems capable of working harmoniously together as a system.

And so with diversification. Obviously it is in the interest of railroad stockholders, but what is it doing to the railroad business? For one thing, capital that is urgently needed for railroads is being used for other purposes. Management talent, such as we have, is not concentrating on the railroad problem but trying to develop greener pastures—all in the interest of railroad stockholders. Earnings from outside sources seems to support a continued independence on the part of individual railroads in dealing with problems that should be dealt with cooperatively

If, in the final analysis, the interest of railroad stockholders and the interest of the public in a sound national rail system cannot be reconciled, a choice will become inescapable. Either we stay in the railroad business, devote our total resources to it, and try to run that business as it should be run in the interest of the public, or we move to more lucrative endeavors and let our public service obligations be assumed by the government. I do not think, in the long run, there is any middle ground. In any event, the railroads are in no position in this present industry crisis to go to the government for help when their record of helping themselves is so poor.

Please forgive the length of this letter but as the head of a highly marginal railroad in the middle of a bitter merger fight that could be resolved overnight if the principal western railroads, most of them well padded with diversified interests, could only agree on a merger pattern, my feelings on the subject are strong.

Sincerely,

JERVIS LANGDON, Jr.,
Chairman and President.

Enclosures.

THE RAILROADS AND CONGLOMERATES

This is a challenging subject and open to serious debate.

On one point however I am clear. During the very difficult period my company, Rock Island, has been going through, an opportunity to diversify into another business and to bring about an improvement in earnings and particularly cash flow would have been most welcome and received with open arms. In fact, Rock Island, in a precarious financial condition, would have jumped at such a chance. But with little cash, and its stock irrevocably assented to one or both of two conflicting merger proposals which have remained unresolved for a much longer time than originally anticipated, Rock Island has hardly been in a position to take the lead in diversifying. Nor has it been a promising candidate for inclusion in a conglomerate organized by others. In this area, Rock Island has been and remains—for the time being—immobile.

It follows that I thoroughly understand and appreciate the reasons for diversification on the part of the C&NW and MKT and other marginal railroads. In their case, earnings from non-transportation sources have been important in maintaining viability. There has been no reason to consider the long term implications of conglomerates or whether, on principle, they should be encouraged or not. With these carriers, the choice was clear: diversify or else. I only wish that Rock Island could have traveled in the same direction, or could do so today.

But this enthusiastic endorsement of conglomerates in the case of the marginal railroad should not be misunderstood. Everyone is interested in survival, even for the short term, and if conglomerates spell survival, they certainly serve a purpose, at least for those who want to survive. The infinitely tougher question is, how are conglomerates to be viewed from the point of view of railroads generally, particularly for the long term? In no sense has diversification been limited to the marginal railroads. Many important railroads, regarded as prosperous in our industry, have embraced the concept. Indeed, the conglomerate is rapidly becoming a way of life.

Is this movement well conceived?

In trying to answer this question I am not concerned with the controversy presently surrounding the conglomerate as a concept. Everyone in Washington seems to be questioning whether the conglomerate is either (1) in violation of the antitrust laws, (2) unsoundly financed, (3) receiving tax benefits that should be curtailed, or (4) generally in conflict with business practices that should prevail in our country. Whether these charges, emanating from many sources including Congressional leaders, the Justice Department, Federal Trade Commission, Securities Exchange Commission, and the New York Stock Exchange, have validity I do not know and do not propose to consider here. On the contrary, I am prepared (at least for the purposes of the discussion this evening) to accept the conglomerate as representing a valid approach to the common control of different business enterprises, with benefits to stockholders, and will concentrate my attention on the single point: Is inclusion in a conglomerate good for railroads generally?

I must confess some doubt.

To begin with, the ordinary conglomerate is apt to include subsidiaries that are users of rail service, perhaps heavy users, and to have an operating railroad in the same corporate home (with users and railroad under the same management control) raises special problems under the provisions of the Interstate Commerce Act and is probably at variance with sound public policy.

But the principal reason for my doubt is that railroads with earnings from conglomerates may find it easier to avoid the tough decisions that are necessary to solve the railroad service problem, and the service problem must come ahead of everything else—even earnings.

Let me be more specific.

Car supply is probably the most important aspect of the railroad service problem. Each railroad of course has its own cars which, being freely interchangeable, constitute its contribution to what is loosely regarded as a national freight car pool. Although there are many special purpose cars in the service of individual railroads, most of the cars in the national fleet are general purpose cars and in demand throughout the country. And yet there is no industry determination of the size of the general service fleet that is required to meet the country's needs. On the contrary, its level is determined by what each individual line concludes to be necessary for its own account, or can afford. The result is a national fleet which at times is inadequate. Moreover, with each line having a voice in its distribution and use, it is also a poorly managed fleet with a level of utilization which, from an industry standpoint, has produced a steadily declining return on investment.

If the private managements of individual railroads are to solve this industry problem of car supply, they must learn to work together, face up to the hard realities of the situation, and pool there resources in finding an answer. The problem must be looked at as an industry problem, and an industry solution must be found even if concepts heretofore regarded as objectionable, including a real pool of general purpose cars managed in the interests of the industry from one control point, have to be resorted to.

But what are the chances of such an approach by railroads with easy earnings from non-transportation sources? I would suspect that they are poor. The trouble is that earnings, whatever the source, produce a sense of well-being, and railroads that satisfy their shareholders in this manner are not likely to want to deal with tough service problems from an industry standpoint, particularly if they detect the slightest chance of a compromise of their own competitive standing. After all, earnings from outside source are not novel in the railroad business, and yet how many of the railroads in the country with large

non-transportation earnings have been willing to come to grips with this crucial service problem? Often their only contribution has been precipitate a continuing controversy over the level of per diem rates—a controversy which, in my opinion at least, does not reach the basic problem.

Railroads, with the help of earnings from non-transportation sources, will be inclined to avoid other aspects of the railroad service problem. For instance, what incentive would there be for a railroad in a prosperous conglomerate:

(1) To work *together* with other lines in the development of merger patterns on a regional, or preferably national, basis in which special interests might have to be subordinated to the attainment of common goals? Everyone agrees that this country has far too many railroads, and that the present systems are poorly balanced.

(2) To work *together* with other lines in the maintenance and operation of through routes with the same clock-like precision that is sometimes found with service between stations on one railroad only, and with the internal accounting performed by one clearing house in accordance with pre-arranged formulae?

(3) To help with the organization of an industry board where internal disputes, such as the proration of revenues arising under joint rates, could be arbitrated?

(4) To work cooperatively in the development and marketing of railroad service in order to stop the erosion of traffic to other modes and to permit the railroads to grow with the economy of the country?

(5) To work *together* with other lines in a determined effort to have removed those restraints, whether legislative or otherwise, which operate to prevent the full development and economic use of the rail form of transportation?

It may be said that for individual railroads to be operated as integral parts of a national system compromises their standing as separate corporate enterprises responsible to their own stockholders, and that such a compromise cannot be demanded in the American tradition of free enterprise. Again the answer is that the railroads are public service companies, and the assumed competitive rights of individual carriers must be responsive to the needs of the public. If railroads in their present form cannot provide an efficient national system, then obviously the form will have to be changed.

I realize that lack of capital for improvements running into the billions has a direct bearing upon the railroad service problem, and that conglomerates, with their promise of greater earnings and financial strength, should be able to help in this connection. But would they really help when the choice is between a railroad investment which produces a small return and another investment which promises a much greater return? I wonder to what extent conglomerates, with earnings from diverse sources, can afford to pump into their railroad subsidiaries the kind of money that is required, particularly when there are so many attractive investment opportunities outside the railroad business.

What it comes down to in the final analysis is this:

The railroad service problem is tough and calls for heroic measures. Only the full and undivided attention of the first team of railroad management, with a willingness truly to cooperate, can possibly come to the rescue. The problem will never be solved if regarded as only another routine problem for someone else to worry about while the first management team is preoccupied with more acquisitions for the conglomerate and more earnings from non-transportation sources.

And if the service problem is not solved, the shippers of the country, finally losing all patience, will demand a change, and what change can there be other than nationalization even though nationalization has not always been a satisfactory answer in other countries? Moreover, if the railroads in the meantime have become conglomerate subsidiaries, a government take-over might be highly welcome. In the history of our country there have been many instances of the spinning off by private enterprise of public service undertakings, and they have invariably ended up in public ownership. There is ample precedent in our own country for the public ownership of railroads.

If this happens, the great pity would be that our American railroads became nationalized because they proved incapable of working *together* effectively in the interest of an efficient *national* railroad system. And it would never be known whether the railroad form of transportation, fully developed and exploited by private management, was capable of holding its own in a competitive transportation market or not.

Exhibit 35

Illinois Central Railroad,
Chicago, Ill., May 19, 1962.

Mr. Thomas M. Goodfellow,
President, Association of American Railroads,
The American Railroads Building, Washington, D.C.

Dear Tom: I have been shown a copy of a letter May 8 from Mr. Hollis G. Duensing addressed to the Subcommittee on Legislation relating to the acquisition and control of carriers and enclosing a copy of remarks delivered by our friend Jervis Langdon before the Minneapolis Traffic Club on April 10, 1969. Mr. Jeramiah C. Waterman also was given a copy of Mr. Duensing's letter and enclosure.

I have not yet inquired as to the procedure being followed by the Subcommittee or by Mr. Duensing but I have read Jervis' statement and, as you might suspect, I myself am in disagreement with his logic and the implied conclusions.

The principal point seems to be that railroad diversification into non-railroad fields will produce "easy earnings" and a "sense of well being" to the degree that the railroad management in a diversified group of companies will not have desire, incentive or a feeling of necessity to solve difficult railroad problems which have plagued the industry for many years. Personally I don't think we need try so hard to cling to poverty as the only stimulus for solving our urgent and ancient problems. The solution to many of these problems will be much easier if diversification should help to improve our access to capital markets and if we can generate enough earnings to retain some of the loyalty and steadfastness of our stockholders.

The second point is the frequently heard suggestion that a diversified management would not be likely to put capital into railroads if in the same family there are opportunities for non-railroad investments producing a greater return. There are two answers to this observation. First, the return on many railroad investments, on an incremental basis, is very great indeed and is certainly not to be judged by the statistics of average return on total existing rail investment. For instance, we are making many investments on the Illinois Central currently which produce between 20% and 65% return, which is generally in considerable excess of the return on investments in our manufacturing companies. The second answer is that good earning railroads must continue to invest in their properties in order to protect those good earnings. Thus the good earners in the railroad industry have considerable incentive to place additional capital in the railroad properties, simply to protect existing good earnings.

Paradoxically, referring to the first argument mentioned above it is the poorer railroads which do not have that incentive and which more quickly might look for opportunities to disinvest.

As might be suspected, we believe strongly in the advantages of diversification into non-transportation fields and I would not want my silence, after reading Jervis' remarks of April 10, to be misunderstood to the contrary. Bearing in mind the new action of the Union Pacific, Southern Pacific, Seaboard Coast Line and Penn Central, as well as the existing holding company organization of the KCS, M–K–T, and C&NW and ourselves, I suspect that others in the industry might also favor an attempt in earnings improvement through non-transportation diversification as distinguished from a choice of relative poverty as a desirable incentive for the solution of problems. Indeed, I believe that diversification is the single most useful goal of a railroad who can achieve it so long as we are unable to make major changes in existing disadvantageous and burdensome government policies. We have been trying to make those changes for a long time and have not succeeded. I believe we should continue trying but at the same time self-help in the form of diversification seems to me to be the path of prudent management.

Sincerely,

William B. Johnson.

[Memorandum W. R. Gerstnecker, Vice President and Treasurer, P.C.T.C. attached to above letters]

July 22, 1969.

Basil Cole: I am returning the papers you left with me including letter of May 26 from Jervis Langdon and a copy of Bill Johnson's letter of May 19 to Tom Goodfellow. I was not sure what I was supposed to do with them except probably give you my comments.

Of course, I agree with Bill Johnson's point of view. Historically, I don't know where the PRR or NYC would have been were it not for the huge investment the Central had in New York real estate and the very sound investment we had in N&W. These, over the years, supplied us with considerable income and gave both of us sources of credit we would not otherwise have had. To a degree they represented benefits from diversification and provided us with solid earnings when rail earnings were down for one reason or another as a result of cyclical downturns in business or inflationary pressures. From the standpoint of Penn Central, we have agreed and have been ordered by the ICC to divest ourselves of our N&W. It seems to me that based on past experience, management in the interest of both stockholders and its transportation function has an obligation to reinvest the funds in a way which will protect the kind of income and asset values we had through our ownership in a company like the old N&W.

The railroad business has habitually been one of feast or famine, depending upon volume or economic conditions. Lately it seems we are suffering from the famine side and until something is done ratewise or otherwise to provide us with the earnings and capital we need, diversification and protection of our income seem vital to me.

W. R. Gerstnecker.

Exhibit 36

[From files of D. C. Bevan, Chairman of Finance Committee, P.R.R.]

October 25, 1966.

S.T.S.: In view of yesterday's discussion, we believe that it is advisable for everyone to have a full recognition of why we are facing the current problem to the extent it is a problem. At the same time, I would like to reiterate that to the best of our knowledge the

total budget of the New York Central for 1967 is in the neighborhood of $80 to $85 million, and we are talking about having an acute problem because our equipment budget alone is in that area, not to mention a request for an all time record road budget.

1. Although we pointed out in both 1964 and 1965 that we thought we were spending money too rapidly despite the overall desirability of the long term objectives, the Financial Department went along with near record capital programs. It was also pointed out that we would be faced with trouble in staying within the debt limitation beyond December 31, 1965. In 1966 we objected as strenuously as we could to the level of capital expenditures because of the effect on the debt limitation and because of the failure of the operating people to meet their commitments of $50 million net income in each year. For the three year period there is a cash deficiency of approximately $45 million. This amount alone would be almost enough to give the Operating people the amount they now wish for equipment.

2. In the Northeast Corridor, we started out with a proposal of spending $10 million on the road and the Federal Government providing almost $10 million for cars for a limited experiment. Very quickly we boosted the level of expenditures on cars to $21 million, thus increasing our commitment to the extent of $11 million. Our original estimate of the cost of road expenditures has soared from $40 million to $33 million, or a total of direct cash drain involved on our system of $44 million, $34 million more than originally contemplated.

3. It now appears we will exceed the original cost of our participation in the Madison Square Garden development by $8 million minimum.

4. If you add all of these together, plus the $10 million increase in inventories, the Operating people in the three years 1964–66, aside from keeping capital expenditures at near record levels, have directly been responsible for an additional cash drain on our resources of $97 million.

5. It is also obvious that some very serious mistakes have been made in our program of acquisition. The reasons for this are hard to ascertain but it may be because of the rapidity with which money has been spent in recent times.

(*a*) The Berwind-White program which in total represents an expenditure of $2.8 million was outlined as a must by the Operating people, including the sales organization. This has obviously been a fiasco.

(*b*) While we still have been unable to get full details, it appears likely that the Associates of the Jersey program, which involves $19.5 million will unfortunately substantially fall into this same category.

Herein lies the truth why today the financial resources of the company have been stretched further than at any time since I have been with the railroad. Throughout this entire period, and the last twelve months money has been scarcer than at any time in my business career, the financial side of the business has met every demand and has initiated a number of unique approaches which although in accordance with good accounting practices are unique and which have materially aided in the expansion of our earnings. The foregoing are the reasons for our present difficulties, but we should also look at some other aspects of the situation.

1. During the ten year period 1956–65 total capital improvements of the New York Central totaled $545 million, those of the Pennsylvania $1 billion 86 million, or twice as much. During this period, or any shorter period that anyone may care to select, we have likewise outstripped the New York Central in expenditures by a wide margin and this is also true for almost any of the other Eastern roads proportionately, and basically the same may be said on a national basis.

2. As indicated by the attached figures, the improvements in our earnings situation has not been material. (See Exhibit I).

3. For the last ten years the average life of our equipment has steadily declined from about 27 years to an estimated 14.8 years at the end of 1966, but despite huge sums spent on equipment, during the first six months of 1966 our share of the Eastern markets was 20.1% as compared to a high in the 60's of 20.9%, in 1962, and, if it is said this was a poor and unusual six months, our share for the first six months of 1965 was 20.5% which compares with the 20.5% in 1961. As indicated by the attached figures, if even in 1965 we had been able to maintain our position in the Eastern markets, we would have had over $5 million more revenue in 1965 than we did. (See Exhibit II).

4. Our current requested program of approximately $58 million for new freight cars in 1967 shows only a return of 6.9%, based on a 20 year life as compared to an average life of our present cars of 14.8%. Using these figures, in the development of which the Traffic Department participated, after we put in an estimated cost of money of about 6½%, there is virtually no return indicated and a great many categories are actually losing money and the general average of 6.9% is up substantially because of the wide margin of profit of bi-level and tri-level racks included in the program.

5. As has been pointed out many times in the past three years, we have rapidly reached a very serious danger point with respect to our ability to carry on new financing. At any time, because of the serious maladjustment in the ratio of equipment depreciation to maturities, Moody's may drop our rating from A to Baa and if this happens our ability to finance equipment, even at a substantially advanced cost, would become extremely difficult, if not impossible, in the present tight money market. Attached hereto is a list of some

of the companies with Baa ratings which will give you some indication as to how far down the quality of our equipment certificates could drop. At the present time our equipment depreciation amounts to about $35 million as compared to average equipment maturities of about $57 million. As contrasted to this, New York Central's equipment depreciation is about $30 million as against maturities of $20 million. Overall our maturities in 1966 were $34 million as compared to depreciation of $54 million. New York Central had combined depreciation of $40 million and total maturities of $20 million. (See Exhibit III).

6. In the three year period 1964–66 it is estimated that our interest charges and depreciation will have increased $17½ million, or about $1.26 per share, and our consolidated debt on the old basis, which excludes recently acquired companies, will have increased by $240 million. During the same period, New York Central's debt is estimated to have increased by $25 million and we estimate their interest and depreciation charges will increase by $4 million.

7. Despite the huge outlays for equipment there still has been no noticeable improvement in our per diem situation during the year 1966. The only decrease in equipment rentals that has occurred is decreased rentals from leading companies and has nothing to do with utilization of our equipment.

I think that everyone realizes, but if not they should, that the analysts have become increasingly critical of our ability to carry through gross to net as contrasted with the New York Central and at least a half dozen investment houses have commented quite unfavorably on the rapid increase in our debt as contrasted to that of the New York Central.

In addition, just recently the Morgan Guaranty Bank which is now a very substantial holder of our stock has manifested great interest in obtaining figures showing projected maturities of Pennsylvania Railroad in relation to our projected cash flow.

While I believe it is highly desirable that we have an efficient fleet, I think the time has come that at least until the merger we are going to have to allow ourselves a breathing spell and go forward on a much more modest basis until the operating people can show a satisfactory return on capital expenditures already made. I believe we are in a very serious position financially from the standpoint of an acute shortage of cash and high maturities in relation to depreciation. Basically there is no question that we still have very substantial underlying strength primarily because of our outside investments of which, of course, the Norfolk & Western is the major one, but this can easily be dissipated if we continue on the road we have been pursuing recently.

In summary, even if we should be successful in obtaining an increase in the debt limit, this would not effectively solve our problem.

1. Even in the present tight money market we have no definite assurance that we are going to be able to raise $85 million next year. For the first time since I have been with the railroad there is a real risk involved from this standpoint.

2. We are facing an acute cash shortage next year for which we have found no solution as yet and any increase in our borrowings to the extent they are obtained from banks will require additional cash for the maintenance of compensating balances in our banks.

3. The most basic and serious problem has to do with our ratings for Moody's. The greater the increase they see in our debt, the more likely they are to analyze our equipment situation and the more vulnerable we are to having our ratings decreased. If this happens, not only will our ability to raise money be curtailed next year, but it will be virtually impossible for us to continue to borrow in future years at the rates we have been accustomed to in the past. The market for the equipment is not good and very very much smaller than the market in which we have been operating.

PENNSYLVANIA RR. CO.

Year	Reported earnings	Pennsylvania Co. dividends included	Supplemental pension past service liability	Adjusted net earnings	Capital and lease expenditures
1965	$33, 896, 504	$23, 000, 000	[1] $6, 917, 000	$3, 979, 504	$244, 236, 000
1964	29, 132, 927	20, 000, 000	[1] 6, 423, 000	2, 709, 927	100, 343, 000
1963	9, 158, 870	14, 000, 000	[1] 6, 918, 000	[2] 6, 121, 130	82, 391, 000
1962	[2] 3, 209, 885	14, 000, 000	[3] 5, 750, 000	[2] 17, 208, 885	62, 951, 000
1961	3, 515, 586	19, 000, 000	[3] 6, 200, 000	[2] 15, 484, 414	60, 869, 000
1960	[2] 7, 819, 112	13, 000, 000	[3] 7, 100, 000	[2] 20, 819, 112	174, 854, 000
1959	7, 267, 135	13, 000, 000	[3] 6, 500, 000	[2] 5, 732, 865	124, 560, 000
1958	3, 544, 073	13, 000, 000	[3] 7, 400, 000	[2] 9, 455, 927	60, 241, 000
1957	19, 056, 885	13, 000, 000	[3] 5, 400, 000	6, 056, 885	91, 705, 000
1956	41, 545, 435	12, 000, 000	[3] 5, 200, 000	29, 545, 435	86, 090, 000

[1] The amounts for 1965, 1964, and $1,280,000 for 1963 represent charges against earnings, comparable to the basis of earlier years if the plan was not in a fully funded position.

[2] Deficit.

[3] Memorandum—provided for in "Reported earnings."

EXHIBIT II

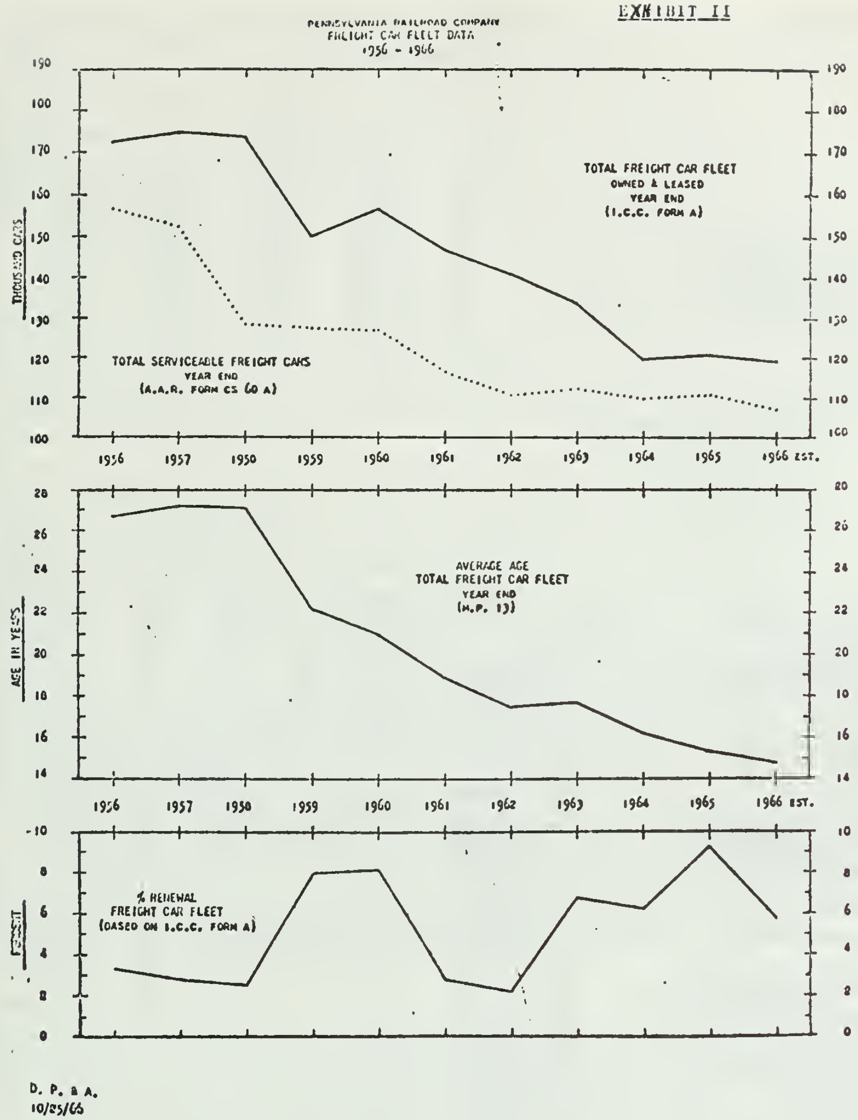

EXHIBIT III

PENNSYLVANIA RAILROAD CO.—GRAND TOTAL FREIGHT CARS OWNED AND LEASED, 1966

Month end balance	Total freight cars	Serviceable units	Percent unserviceable
January	122, 246	112, 065	8
February	121, 613	111, 062	9
March	121, 345	110, 644	9
April	121, 354	110, 531	9
May	121, 196	110, 031	9
June	120, 850	109, 448	9
July	120, 466	108, 959	10
August	119, 838	107, 953	10
September	519, 620	107, 641	10

Source: Financial review statement.

PENNSYLVANIA RAILROAD CO., EFFECT ON 1965 REVENUES FROM CHANGES IN 1965 MARKET POSITION VS. 1964

[Dollars in thousands]

	P.R.R.	N.Y.C.	B. & O.-C. & O.	N. & W.	Other	Total Eastern District
Coal	($1, 108)	($3, 665)	$5, 284	$8, 18[illegible]	($8, 693)	
Ore	(2, 367)	473	961	(281)	1, 214	
Grain	342	(895)	(265)	(669)	1, 487	
Food and kindred products	(1, 306)	(1, 004)	837	(904)	2, 377	
Pulp, paper, and paper products	(388)	(1, 079)	2, 416	(65)	(884)	
Chemicals, rubber, and plastic	506	1, 118	(905)	373	(1, 092)	
Stone, clay, and glass products	(334)	652	184	1, 520	(2, 022)	
Iron and steel (including scrap)	(109)	2, 436	4, 109	(2, 073)	(4, 363)	
Machinery and appliances	(140)	(1, 908)	1, 250	399	399	
Motor vehicles and parts	4, 924	2, 127	(4, 283)	175	(2, 943)	
All other	(4, 723)	660	(2, 714)	(5, 572)	12, 349	
Total	(4, 703)	(1, 085)	6, 874	1, 085	(2, 171)	

Note: Figures in parentheses are unfavorable.

PENNSYLVANIA RAILROAD CO.—1967 NEW FREIGHT CAR PROGRAM RATE OF RETURN STUDY

			Rate of return (percent)					
			14-year life		20-year life		25-year life	
Type and description	Quantity	Initial cost	Before taxes	After taxes	Before taxes	After taxes	Before taxes	After taxes
X58a—Noninsulated grocery	150	$2, 842, 500	7. 0	3. 6	9. 0	4. 7	9. 9	5. 1
X58c—Lading straps adjustable	300	4, 800, 000	10. 9	5. 7	12. 9	6. 7	13. 8	7. 2
Total, X58	450	7, 642, 500	9. 5	4. 9	10. 7	5. 5	11. 6	6. 0
X61c—Fisher body 60–70 ton	200	4, 000, 000	9. 9	5. 1	11. 8	6. 1	12. 7	6. 6
X61d—Double door 60–70 ton	80	1, 988, 000	6. 7	3. 5	8. 6	4. 5	9. 5	4. 9
Total X61	280	5, 988, 000	8. 8	4. 6	10. 0	5. 2	10. 9	5. 7
X60—86 foot box (Chevrolet)	49	2, 058, 000	. 2	. 1	2. 1	1. 1	3. 0	1. 6
X60—86 foot box (Oldsmobile)	10	420, 000	17. 7	9. 2	19. 6	10. 2	20. 5	10. 7
X60—86 foot box (Chrysler)	200	7, 600, 000					. 6	. 3
X60—86 foot box (Ford)	18	720, 000	6. 9	3. 6	8. 8	4. 6	9. 7	5. 0
Total, X60	277	10, 798, 000			1. 5	. 8	2. 4	1. 2
Grand total, boxcars	1, 007	24, 428, 500	4. 9	2. 5	6. 9	3. 6	7. 8	4. 1
Covered hopper—4,600 cubic foot	160	2, 576, 000	9. 5	4. 9	11. 4	5. 9	12. 3	6. 4
Covered hopper—3,000 cubic foot	100	1, 445, 000	17. 6	9. 2	20. 4	10. 6	21. 3	11. 1
Total, covered hopper	260	4, 021, 000	12. 4	6. 4	14. 2	7. 4	15. 1	7. 9
G-43—52 feet 6 inches gondolas	600	8, 400, 000	6. 4	3. 3	8. 3	4. 3	9. 2	4. 8
G-41—100-ton coil covered gondolas	82	1, 640, 000	17. 2	8. 9	19. 7	10. 2	20. 6	10. 7
Total, gondolas	682	10, 040, 000	8. 2	4. 3	11. 8	6. 1	12. 7	6. 6
H-43—100-ton hoppers	1, 200	16, 380, 000	9. 9	5. 1	11. 8	6. 1	12. 7	6. 6
Racks—Bilevel	125	687, 500	73. 6	38. 3	73. 6	38. 3	73. 6	38. 3
Racks—Trilevel	237	2, 014, 500	84. 4	43. 9	84. 4	43. 9	84. 4	43. 9
Total racks	362	2, 702, 000	81. 7	[1] 42. 5	81. 7	[1] 42. 5	81. 7	42. 5
Grand total, new freight car program:								
Cars	3, 149							
Racks	362	57, 571, 500	11. 0	[2] 5. 7	13. 2	[2] 6. 9	13. 9	7. 2

[1] Rate of return on racks based on 7-year life.
[2] Excludes cost of money.

[From files of D. C. Bevan, Chairman of Finance Committee, P.R.R.]

NOVEMBER 8, 1967.

Mr. SAUNDERS: There follows an analysis of *our financial position* as it exists today divided into three major areas: (1) *Cash Needs*, (2) *Financing Possibilities*, and (3) *Debt Limitation Under Our Merger Agreement.*

Cash Needs

The Pennsylvania Railroad Company requires, in order to maintain adequate balances in its banks to cover activities and loans, an average cash balance of somewhere between $45 and $50 million. We have not had balances in this area at anytime this year and at the end of October our cash balance amounted to roughly $8,500,000. In order to augment it

we had borrowed funds from Pennsylvania Company and others amounting to approximately $14 million or a total of only $22 million. Based on current estimates of cash flow, this balance will be reduced by the end of November to $20 million, including borrowed funds and by December 31 to zero. Because of heavy cash requirements in the first quarter of the year, the zero balance will deteriorate by the end of January to minus $6 million; to minus $19 million by the end of February and to minus $22 million by the end of March. This means that we must augment our cash as quickly as possible. At least $45 million must be raised within the next 30 or 40 days and an additional $20 million early in 1968 to see us through the first quarter. This is necessary to provide protection against low cash balances which occur at times other than the end of the month because of large pay-roll, maturity, traffic settlement and dividend requirements.

In order to protect our cash position, we have expedited the sale of capital assets and utilized other means wherever they have been available. This includes the sale of the N&W debentures we have received in exchange for N&W stock; temporary loans from banks against expenditures made in building the Waynesburg Southern and expenditures made to rehabilitate freight cars under Equitable leases; the sale of Macco receivables under a complicated arrangement to avoid increasing our debt; and the declaration out of Richmond Washington Company of dividends in R.F.&P. stock which we sold. We recently have agreed with the N&W to take down $10 million additional of their debentures in the so-called floater we had with them and have prevailed upon them to accelerate the delivery of the 1968 debentures from June to January. In view of the current market condition and the price of N&W stock, it is estimated we can raise approximately $17,500,000 through the sale of these debentures when we receive them in December and January, respectively. These debentures are owned by Pennsylvania Company and that Company will have to retain approximately $2.5 million of the proceeds for its own cash purposes so that the net amount available to augment PRR's cash, if such sales are made, will be approximately $15,000,000 and about $9 million of this will not become available until January when the second group of N&W debentures is scheduled to be delivered to us.

We have explored thoroughly with investment bankers in New York the possibility of selling a Pennsylvania Company preferred stock. It is apparent that such sale in the amount we require would be extremely difficult to market even at an unreasonably high dividend rate. Furthermore, a preferred issue would of necessity contain extremely burdensome conditions and covenents which would limit Pennsylvania Company's future financial activities and dividend policy. In addition, the issuance of preferred stock, which would have to be non-callable for at least 10 years, would be highly disadvantageous from an income tax standpoint because the dividend on preferred would have to be earned without the income tax deduction for interest available through the issuance of debt. Therefore, this means of financing had to be discarded.

Investigations have been made of the possibility of selling the dividends Pennsylvania Company will receive over the next three years prior to the termination of the Wabash lease with N&W without success. These dividends would amount, over the next three years, to approximately $21 million and if they could be sold on a reasonable discount basis, the net proceeds would have been about $19 million. No practical way has been found to do this without such a sale being construed as debt and it would require the repayment over the next three years of $7 million a year.

In view of the fact that our total annual maturities now equal or slightly exceed our depreciation, any financing or raising of funds which would require additional annual maturities over the next three years of $7 million would not be a sound move. It is not feasible to liquidate N&W stock at the present time because we do not have a sufficient number of shares free of pledge which could be sold and we cannot sell our Wabash stock which eventually will be converted into N&W because such sale would take the Wabash out of our consolidated tax shelter thereby cutting the present rent in half.

In summary, we believe it is necessary to issue and sell debt securities. As mentioned above, our cash needs total $65 million and if $15 million of this can be raised through the sale of N&W debentures, we should issue and sell at least a $50 million Pennsylvania Company debenture. This will require I.C.C. approval and take a considerable while to do, which means that we may have to draw on our revolving bank credit as an interim measure to cover our cash requirements pending receipt of the proceeds of the debenture sale. In any event, we will require an increase in the debt limitation provided in our merger agreement as explained in more detail below.

Debt Limitation Under Merger Agreement (See Exhibit Attached)

Our merger agreement with the New York Central restricts the amount of debt which can be issued by P.R.R. and New York Central prior to our merger. Originally this limitation provided a margin of $100 million increase in debt subsequent to the date of the merger agreement. The Boards of Directors of each company authorized an increase in the $100 million limitation to $195 million and the latter figure is now the controlling factor. Up to a fairly recent date, we have been able to live within this limitation primarily because of two actions we took to provide relief, namely (1) the sale of 2 Penn Center which reduced our outstanding debt by the amount of mortgages outstanding on that property and (2) the conversion of equipment debt owned by our Pension Fund into preferred stock. You are familiar with these transactions which provided about $28 million of additional leeway. In addition, we planned to stretch out the debt issuance for a substantial part of our 1967 equipment program until we could absorb it as a result of maturities next year. However, the recent ordering of 100 diesels, costing $28 million, to be

delivered in December, January and February and the agreement to take eleven high speed cars originally intended for SEPTA into our Northeast Corridor program in December has made it impossible for us to stay within our debt limitation. The amount by which we will overrun our limitation is further increased by the financing we now must do to meet our cash needs. In addition, debt financing for other capital expenditures in our 1968 program will undoubtedly be moving in on us.

As we now stand, at the end of 1967 based on the debt which will be outstanding at that time, we will be under our debt limitation by only about $16 million. With deliveries of the balance of the diesels in January and February and the balance of the Northeast Corridor cars, as well as the financing of the 1967 carryover expenditures, we will be somewhere in the area of $22 million beyond our debt limit by the end of February. If we add to this the $50 million to be raised from the sale of Pennsylvania Company debentures, our excess debt will be $72 million. Assuming that our merger will not take place before the end of March 1968, we should promptly request additional authority from the New York Central for at least $75 million.

DAVID C. BEVAN.

On the basis of Exhibit 2 in the papers distributed at July 29 meeting, consolidated net earnings, without a steel strike, are estimated at a loss of $36,227,000 for the third quarter as against an announced target by Mr. Saunders of $15 million. In a plan outlined by D. E. Smucker at the meeting, going through Phase I, savings of $10,750,000 would be effected or at the balance of the third quarter $21,500,000. In addition, other ways and means of bridging the gap were considered and as of now the figures would appear as follows:

Estimated consolidated losses, $36,277,000.

Savings by D. E. Smucker	$21, 500. 000
Discount bond purchases	2, 000, 000
Additional real estate sales*	4, 300, 000
Additional revenues from H. W. Large	15, 000, 000
Savings on expense accounts	500, 000
10% reduction from departments other than operations	1, 400, 000
Increased earnings from subsidiaries**	5, 000, 000
Total	49, 700, 000

*S. H. Hellenbrand only has potential sales on the horizon for a total of $4,500,000 or $2,800,000 not contained in the above figures.

**D. C. Bevan checking.

Note.—Gap yet to be bridged, $1,500,000—based on above figures.

EXHIBIT 37

[From files of D. C. Bevan, Chairman of Finance Committee, P.R.R.]

AUGUST 30, 1968.

MR. SAUNDERS: Primarily because of the delay in consummating our merger the net working cash [1] of the Pennsylvania Railroad on February 1 was at an all time low of $5.5 million. On the same date the New York Central had net working cash of $7.8 million, giving Penn Central combined working cash of $13.3 million, obviously totally inadequate for the operation of a corporation of our size, and also to maintain proper compensating balances with our banks. Coupled with this, a capital budget for over $300 million was approved for the year 1968.

All of these factors combined created a very difficult situation both from a cash standpoint and also from the standpoint of financing requirements of the merged company. Despite these problems, we probably could have worked out this situation gradually over a period of some months, but the gravity of our situation has been compounded by the fact that Penn Central had a $48 million deficit from railroad operations in the first six months of this year and a cash loss of $88 million. Further cash losses have occurred in both July and August in an estimated amount of $43 million.

This drastic cash drain is going to have a very serious effect, not only this year, but certainly through 1969. Our best estimate at the present time indicates by the end of this year we will have $100 million of commercial paper outstanding, we will have used up our entire $100 million revolving credit with the banks, and we will still be short somewhere between $125 and $150 million.

We only have a limited number of ways of closing the gap:

(1) A further reduction in expenses and this does not appear feasible in light of plans already in process for retrenchment which have been taken into account in our cash flow estimates.

(2) Sale of assets. Increased sales of real estate is one possibility, but it seems unlikely that we can realize a substantial amount during the balance of the year over and above present estimates. Another possibility is the sale of Strick. It will be difficult to accomplish this without a loss that would be charged against our operating income since at the present

[1] Net working cash is after deducting the temporary bank loans which have been converted into Commercial Paper or our Revolving Credit.

time its level of earnings is not on a satisfactory basis. However, initial steps have already been taken to explore this possibility with three potential purchasers. Another possibility for a source of funds is the sale of the TP&W, the Santa Fe being the most likely purchaser, and this will be explored with them promptly. Walter Grant has been asked to explore the seal of Toronto, Hamilton & Buffalo with N. R. Crump, Chairman and Chief Executive Officer of the Canadian Pacific. Obviously, we are hopeful that we will be able to improve our position somewhat through some of these possible sales but at the time time it is evident that there is no hope of substantially closing the gap from this source.

(3) An immediate and drastic reduction comparable to what we are doing on the expense side on capital expenditures where cash is involved.

(4) Additional financing other than equipment financing. We hope to have our blanket mortgage ready to allow the sale of possibly $50 million of bonds before the end of the year but with a new mortgage of this type and with current conditions in the bond market, this is probably the most we can do initially.

If, as and when we solve the problem of finding the required $125 to $150 million, we are still faced with the necessity of placing on a long term basis as quickly as possible the $200 million of short term maturities in the form of bank loans and commercial paper, plus a cash deficit of an undetermined amount during the first half of next year. The latter will undoubtedly be substantially above that for 1968 if we take over the New Haven as of January 1.

If we assume in 1969 the Penn Central on a parent company basis reports $40 million net income, and there are reasons to believe this may be on the optimistic side, only about $30 to $33 million of this at best will represent true cash flow. If you add to this $100 million of depreciation and possibly $20 million from the liquidation of assets, we will only have a total of about $150 million of cash resources. Against this amount are requirements consisting of $100 million for maturities of which approximately $74 million is equipment debt. The total amount of maturities will absorb our total depreciation of $100 million. In addition to the maturities $8 million will be needed in connection with the New Haven settlement if this occurs on January 1 or thereafter, and $55 million for common stock dividends or approximately $58 million if the New Haven is acquired in January. In other words, there will be a cash deficiency of about $15 million before any allowance is made for road capital expenditures. In my judgment, we are faced with the most serious problem, from a financial viewpoint, that I have encountered since I have been with the railroad. Ways and means must be found to resolve them, but under the most favorable circumstances it is going to take a substantial amount of time. In the meantime, I see no alternative but to stop all capital expenditures which represent a cash drain until such time as we can re-establish a positive cash flow.

It is my recommendation that we have a small meeting immediately to determine how drastically retrenchments can be made which I believe will require complete cooperation from management at all levels. I would suggest that in addition to you, Mr. Perlman and myself, such a meeting should include Messrs. Smucker, Grant, Gerstnecker and Hellenbrand. If the foregoing has your approval may I distribute copies of this memorandum to the individuals mentioned on a personal and confidential basis prior to the meeting.

David C. Bevan.

Exhibit 38

[From files of S. T. Saunders, Chairman of the Board, P.R.R. and for use at August 1964 P.R.R. board meeting]

Memorandum for the Directors

RESULTS

Net income for July was $1,500,000, slightly less than the forecast. Total revenues of $73,900,000, increased $3,300,000, over the forecast, which increased was more than offset by increases in operating costs including an accrual of $2,300,000 for retroactive increased wages and fringe benefits.

Assuming that the current trend in traffic volume continues, August revenues could exceed the forecast and the August net income forecast of $3,000,000 could be realized.

The earlier than usual resumption of automobile production in August has assisted in increasing revenues by an estimated 3% over a year ago. Coal loaded on line has shown above average increases with 351 unit trains scheduled for operation during the month.

Travel to the World's Fair increased further in August. There have been 160 extra trains to and from New York on account of the Fair through August 16, carrying 113,900 passengers. By the end of August, it is expected that $3,000,000 added revenue will have accrued as a result of the World's Fair.

The Boy Scout Jamboree proved to be quite successful. Travel to Valley Forge in July is estimated to have produced revenues of $375,000.

CASH SITUATION

Net cash at the end of July totaled $5,400,000, which is about what was estimated. Our estimate of net cash for the end of August is $5,000,000, which compares with $13,200,000 at the end of August 1963.

LABOR STATUS

On August 7th, a Presidential Emergency Board made its recommendations in connection with the Shop Crafts Organizations' engineers provide that $23 per month will be set aside for each qualifying employee for health and welfare beginning in June of this year. It also grants the engineers, effective June 1st, an increase in the basic daily rate of $1.75 and to engineers in road freight and yard service an additional $1.50 for each day they are required to work without fireman. Demands for increased pay, job stabilization, etc. filed by the a number of other labor organizations are in various stages of handling.

N&W-NICKEL PLATE-WABASH UNIFICATION

As you know, the Interstate Commerce Commission on July 13th released its order conditionally approving the N&W-Nickel Plate-Wabash unification. Among the conditions of approval is the requirement of complete divestiture by the Pennsylvania of its financial interests in the Norfolk and Western and Wabash within a ten-year period during which all voting rights in N&W stock must be transferred to three independent voting trusts.

We are required to notify the Commission not later than September 17th as to our intent to proceed with a plan of divestiture. The order also directs that all Board and management relationships between PRR and N&W must be severed by October 17th and that consummation of the transaction take place by November 16th.

The Erie-Lackawanna, Delaware and Hudson, and Boston and Maine were given five years in which to file petitions for affiliation with the N&W.

PENNSYLVANIA COMPANY—BUCKEYE MERGER

The Interstate Commerce Commission on July 15th approved the issuance by Pennsylvania Company of 707,626 shares of 4⅝% cumulative preferred stock, clearing the way for the merger of The Buckeye Pipe Line Company into Pennsylvania Company, effective July 24th.

GREAT SOUTHWEST CORPORATION

Pennsylvania Company on July 15th purchased 518,367 shares of stock of Great Southwest Corporation bringing the System holdings to 532,867 shares, or 49.4% of the total outstanding stock, at an aggregate cost of $12,196,000.

MASS TRANSIT BILL

The Mass Transit Bill signed by the President on July 9th authorizes a total of $375,000,000 over the next three years for grants to state and local bodies on a ⅔ Federal ⅓ state or local basis. However, the money must still be appropriated by Congress.

ADDITIONAL MU CARS FOR PHILADELPHIA AREA

An agreement has been reached with the City of Philadelphia, subject to approval by City Council and our Board of Directors, providing for the lease from the City of 20 more new electric commuter cars for use in the Philadelphia area under contract with the Passenger Service Improvement Corporation (PSIC) and Southeastern Passenger Transportation Compact (SEPACT). Under the new agreement, the fleet of such cars will be increased to 58 and rental will be changed from a mileage basis to a flat payment of $60,000 a year, which should provide greater flexibility in the use of the cars.

UNIT TRAINS

Unit train operations continue to grow. During June we handled a total of 327 such movements. All but 16 of these were coal trains averaging 7,000 tons with several trainloads of 9,400 tons and one of 14,800 tons.

Joint studies have been initiated with the United States Steel Corporation for the purpose of establishing in August a "Unit [sic] .

Merger

Some thirty parties filed briefs in our merger case on June 1. Many of these briefs supported the merger and generally all of them were about what we expected. The Department of Justice continues to oppose the merger basically along anti-trust lines. Its anti-merger position is based on the premise that the public interest would be better served if the two lines remainded independent of each other. While admitting that the two roads have been going through a difficult period, which would be for the most part solved by the merger, the government, nevertheless, maintains that the nation's expanding economy and the railroads' own vigorous self-help plans will ease their difficulties.

Since the filing of the Justice Department brief, I have received a telephone call from Attorney General Kennedy who invited me to come to Washington to talk to him concerning our case generally. I expect to do this in the next few days and am hopeful that we may be able to modify the department's position.

The State of New York filed a generally helpful brief and did not oppose the merger itself. It did insist on inclusion of the Erie-Lackawanna in the Norfolk and Western system and suggested that our record be held open for five years to consider the inclusion of other railroads.

The Bureau of Inquiry of the Interstate Commerce Commission filed a very helpful brief which assumed the merger would take place. In addition, it suggested that the petitions for inclusion of the Susquehanna, the Brooklyn Eastern District Terminal and the Erie-Lackawanna be denied. It recommended retention of I.C.C. jurisdiction for five years to consider inclusion of the New Haven, Boston and Maine and Delaware and Hudson, indicating that they could not be included at this time.

The Transport Workers Union included with its brief a motion to have the record reopened to consider the effect of the work rules settlement. We intend to reply to this motion this week and do not anticipate that the record will be reopened for this purpose.

On June 8, the New Haven requested a hearing before the Commission for consideration of our proposals to solve the New England rail problem which were included in our brief. We conferred with New Haven representatives last week and they have submitted to us an alternate proposal for the purchase by the Penn Central system of the New Haven's operating and various other assets incident thereto. In brief, their proposal contemplates the sale to us of the New Haven's assets free and clear of all liens, except equipment trusts liens in the amount of approximately $22 million, which could be disaffirmed if the equipment is not desired, for a purchase price of roughly $80 million. A condition of the sale would be the elimination by the New Haven trustees of all New Haven passenger service prior to the transfer of the assets. Obviously, this new proposal has great responsibilities and I am hopeful that we can reach some agreement with the New Haven trustees concerning this property in the reasonably near future. If we agree to absorb the New Haven, we would, of course, expect the Boston and Maine to become a part of the N&W–NKP–Wabash system.

Labor

We continue to make progress under Arbitration Award No. 282. As of June 15, we were operating an average of almost 500 assignments a day without firemen and had gross wage savings of approximately $468,000. As of this date, we had operated a total of 10,455 yard crews and 3,619 road crews without firemen. We also had terminated the services of 717 firemen.

As of June 21, we had paid severance allowances in the amount of roughly $60,000 to 65 people. We estimate that by the end of the first year we will have annual wage savings from the elimination of firemen of [sic] have vigorously opposed any sale of R.E.A. stock to Greyhound, indicated they may be willing to have Greyhound obtain some interest in the company.

In sum, for the first time progress is being made in obtaining carrier agreement to disposing of at least a portion of the stock of this company. Mr. Carpi will continue his efforts to achieve a solution to this problem. As you know, our stake could amount to about $11 million.

Transcontinental Divisions

You will recall that our case seeking increased divisions on transcontinental traffic, which has been pending before the Interstate Commerce Commission for several years, was decided favorably to the Eastern lines in March 1963. The decision will mean approximately $24 million annually in increased revenues to the Eastern lines. The Western lines have appealed the case to the Courts and a hearing is expected to be held some time in October.

Since the I.C.C. decision, we have discussed the case informally with one of the larger Western roads which has indicated a disposition to settle the matter. Subsequently, the Western lines held a meeting to consider the matter and while there was no unanimity among the group, they will meet again to consider the matter further. We are, of course, hopeful that some compromise may be reached in order that we may start dividing transcontinental revenues on a more favorable basis than present. Our interest amounts to between $5 and $6 million annually based on the I.C.C. decision.

Commuter Service

The Pennsylvania Public Utility Commission released its order yesterday permitting the discontinuance of our 19 local trains in the Pittsburgh area. This order, unless appealed to the Courts, becomes effective in 60 days and will amount to the complete withdrawal of all our Pittsburgh commuter service.

Greyhound Proposal to Purchase Railway Express Agency Stock

As you know, the Greyhound Corporation has been trying to buy an interest in Railway Express. At the present time, it is negotiating for 500,000 shares of authorized but its unissued stock at $20.00 a share. The proposal would also include an offer by Greyhound to purchase a million of the approximately 1,999,000 outstanding shares now held by railroads at the same price. However, Greyhound says that it will not go through with this offer unless at least 80% of the REA stockholders favor the transaction. At present, 73.5% of the REA stockholders are favorable to the proposed purchase. There is some opposition remaining among the Western lines which believe that control by Greyhound will adversely affect their freight forwarder business. We should know shortly whether the required 80% will be achieved. As a matter of fact, it is now up to the Milwaukee Road and the Hill Lines, i.e., the Great Northern, Northern Pacific and Chicago, Burlington and Quincy, which own 8.3% of the REA stock as to whether the transaction will be consummated. It now looks as if there is a 50–50 chance of approval with a decision within a matter of a week or two.

Our interest in the Express Agency amounts to nearly $9,000,000. Of this amount approximately $3,600,000 is in deferred notes and the remainder of over $5,200,000 in common stock (at $20.00 per share). The notes are not payable at the present time. If the transaction goes through, we could probably sell as much of our stock as we desired. There is a strong feeling that under Greyhound's management the stock will appreciate. At present we are thinking in terms of selling approximately half our stock for $2,600,000 and retaining the other half in the hope that it will appreciate.

EXHIBIT 39

[From files of D. C. Bevan, Chairman of Finance Committee, P.R.R.]

DECEMBER 1, 1966.

Mr. JAMES W. ASTON,
Chairman of the Board,
Republic National Bank of Dallas, Dallas, Tex.

DEAR JIMMY: I am really rather disturbed and at the same time puzzled by a recent conversation I had with Angus Wynne with respect to his inability to borrow money at your good bank.

There is one cardinal principal I have had in all the years I have been with the Pennsylvania Railroad and that is I would not maintain any bank relationship where we do not at the same time have the ability to borrow. I am sure that is not the case here, but certainly it is something we must get straightened out.

The Great Southwest Corporation has its principal account with you and I think I have said before I thoroughly believe that we should have at least two accounts in each city where we do business. In addition to Great Southwest having an account with you and in order further to improve the situation, we have several times honored requests from Norman Ramsey to purchase certificates of deposit and only recently purchased one.

I plan to be in Texas next Wednesday for a Great Southwest meeting and perhaps we can find a few minutes to get together to clarify the situation. I would also like to have the opportunity to have W. R. Gerstnecker, our Treasurer, and myself talk to your Trust Department people since we would greatly appreciate their acquiring some of conditional sales contracts of the Pennsylvania Railroad in January and which I might say will be at a most liberal rate of interest and far above that which I have been use to paying and that which I expect to pay after the first half of 1967.

Best regards.

Sincerely,

DAVE.

bcc: Mr. Angus G. Wynne, Jr.

EXHIBIT 40

[From files of W. R. Gerstnecker, Treasurer, P.R.R.]

THE PENNSYLVANIA RAILROAD CO.,
September 22, 1967.

Reply to: 1334 Transportation Center, 6 Penn Center Plaza, Philadelphia, Pa.

Mr. CHARLES J. HODGE,
Glore, Forgan, Wm. R. Staats, Inc.,
New York, N.Y.

DEAR CHARLIE: Attached is a brief description of the new Great Southwest preferred stock we have been working on. You will recall in Great Southwest we have arranged two 3-year loans at banks for a total of $6 million; one short-term loan for $3 million; and we are taking $3 million of this preferred in our System companies and funds. We are planning to issue it in the first week of October.

We could use $2 million more in the preferred and I thought you might see whether you can find any interest in that amount. Actually, if you can find more than $2 million it would be helpful to us to take less in our funds. We want to keep the total at no more than $5 million.

I am sending a copy of this to Bill Loesche at Penn Mutual just to see whether he has any interest and I certainly have no objection to you or your people talking to him about it.

If you have any questions or make any progress in this matter, please call Bob Loder our Assistant Treasurer here in the office at 594–3231, who is entirely familiar with this matter.

This is more or less my swan song for the next three weeks or so and I hope during that time things straighten out a bit for you and give you more breathing space.

Sincerely,

W. R. GERSTNECKER, *Treasurer.*

Great Southwest Corp.

SERIES A SENIOR 6.5 PERCENT PREFERRED STOCK

Amount: 500,000 shares, $10 par value each, or a total par value of $5,000,000.

Dividend: 6½% per annum cumulative, payable quarterly.

Voting Rights: Non-voting, except as specifically set forth in the Articles of Incorporation or as provided by law.

Position: Senior to present voting preferred which totals 350,000 shares with total par value of $3,500,000. Stock on a parity with the Senior Preferred is limited to an additional 1,100,000 shares unless approved by vote of at least two-thirds of the Series A, Senior Preferred.

Stock ranking prior to the Series A, Senior Preferred cannot be issued unless approved by holders of at least four-fifths of the Series A, Senior Preferred.

Optional Redemption: All or part of the stock may be called for redemption at any time after September 30, 1972 upon not less than twenty or more than fifty days prior notice. The premium is 5% for redemption during the first year following September 30, 1972 and decreases by ¼ of 1% each year thereafter until after September 30, 1992 when it becomes redeemable at par.

Mandatory Redemption (Sinking Fund): On the last day in September of each year commencing in 1971 such number of shares shall be redeemed as may be necessary in order that the number of shares of Series A Senior Preferred outstanding shall be reduced each year by 5% of the total number of shares issued prior to September 1, 1971. The mandatory redemption price shall be par plus accrued unpaid dividends.

Exhibit 41

[From *Traffic World*, Mar. 1, 1969]

(By Colin Barrett)

'Conglomerates' and Public Responsibility

> The decades-old issue of regulatory benefits versus liabilities is being raised in a new guise, as railroads find shelter, in corporate restructuring, from traditional limitations on their non-transportation activities.

Recent diversification efforts by the U.S. railroad industry have evoked considerable speculation as to the amount of control—if any—the Interstate Commerce Commission should exercise over these moves.

Railroad industry leaders contend that any ICC interference would "effectively destroy the most efficient method by which the railroads can diversify." And diversification, they add, is of vital importance to provide a broader and more secure financial base for their rail operations.

Detractors, however, feel that the roads' expansion into other businesses may relegate their railroad operations to a position of secondary importance in complex, multi-faceted "conglomerate" corporations, to the possible detriment of their rail service. Among those urging ICC action of some sort on this subject are its Bureau of Enforcement and one of its most respected hearing examiners, as well as both the chairman and a ranking member of the House interstate and foreign commerce committee.

Inherent in the diversification controversy is the dualistic status of the railroads. On one hand, they are regarded as a public utility, and regulated as such, while on the other they are viewed as independent businesses in a free-enterprise economy. Creation of the conglomerates, involved in railroading as only one of many diverse business activities, serves to add yet another element to this already problematic situation.

The railroads are accomplishing their expansion by creating "parent" holding companies, which then reach out into other businesses to become true conglomerates. The purpose of this inverse type of business "genetics"—a "child" fathering its own "parent"—is to free the railroads themselves from what they regard as crippling ICC supervision of their nontransportation activities.

The advantages of this kind of diversification, from a strictly business vantage point, are numerous. Comparative to other U.S. industries, the railroad industry has been classed by financial experts as "stagnant," or even "moribund." By failing to progress at the same rate as other industries, railroads have fallen to next to last on a list of U.S. industries compiled by the First National City Bank of New York and based on rate of return on net investment; only investment trusts, of all major U.S. industries, rank below the railroads on this list.

According to spokesmen who presented the railroads' successful case for their latest rate increase (in Ex Parte 259, Increased Freight Rates, 1968) at the Commission, labor

cost increases and spiraling prices are keeping the railroads from improving their position (T.W., March 30, 1968, p. 185). Meanwhile, an inflationary economy is pushing other industries not hampered by regulatory restraints further and further ahead of the railroads.

Alan Roth, a partner and railroad analyst at the New York firm of Roth, Gerard & Co., Inc., described the situation this way in a recent article in *The Institutional Investor:* "The roads' normal economic uncertainty has been reinforced by the negative effects of recent sharp wage inflation in an industry which cannot easily raise prices. With longer-term earnings prospects dimmed, management has begun to look around for more aggressive businesses. Also, there is increasing interest in what diversification for its own sake can mean for common share prices. Finally, the roads have come to realize that they themselves may be vulnerable to takeover by more aggressive outside groups."

The response of the financial community to the railroads' diversification efforts has thus far been enthusiastic. Mr. Roth noted that "shares in acquisition-minded roads . . . have been bid to significant premiums over conventional rail multiples." This enthusiasm is enhanced by figures such as these, applied to the largest of the present rail conglomerates. Northwest Industries, Inc. (parent of the Chicago & North Western Railway): On the basis of its present consist, Northwest Industries would have produced *pro forma* earnings of $54 million in 1967, despite a $12 million rail operating loss.

To an individual railroad, standing alone, persistent operating losses spell financial disaster and eventual bankruptcy. Yet, to a conglomerate, losses incurred by its railroad component can benefit the balance of the corporate structure by providing "tax shelters" for other, profitable members of the complex. Moreover, the conglomerate parent can supply funds for needed capital expenditures—fund's that the railroad itself simply could not afford.

ICC Hearing Examiner Henry A. Darmstadter, in his recommended report approving the proposed C & N W-Chicago, Milwaukee, St. Paul & Pacific railroad merger, noted that diversification can provide an otherwise weak railroad with the support it needs to revitalize its operations (T.W., Dec. 21, 1968, p. 63). This point was reinforced by the Commission itself in another context, as it considered formation of a holding company by the Missouri-Kansas-Texas Railroad (T.W., Jan. 6, 1968, p. 32):

"Katy's management and principal stockholders are convinced that only by formation of a non-carrier holding company to own the stock of Katy will the equity interest of stockholders prove sufficiently attractive to make possible favorable investments in non-transportation enterprises. The new holding company would be able to issue both equity and debt securities not presently possible, and would, in turn, permit funds generated by non-transportation enterprises to be made available for Katy's rehabilitation."

Simply increasing their size through acquisitions, too, gives the railroads an advantage. Banks make size a principal factor in their consideration of loan requests, for example. Furthermore, the conglomerate is becoming more and more common in the U.S. economy, and the railroads feel they must grow in order to compete.

Another element, albeit a limited one, must also be mentioned. The Penn Central, under orders from the ICC to dispose of its stockholdings in the Norfolk & Western, is able to use its N & W stock as currency in acquisition transactions, thus protecting itself from the problems and attendant monetary disadvantages in disposing of the enormous number of N & W shares on the open market.

NEW HAVEN PROBE

For all of these advantages, however, diversification is not without its dangers. It was recognition of these dangers that originally caused the ICC to propound its oft-restated policy that "a carrier's major endeavors should . . . be confined to matters related to transportation."

This attitude is primarily responsible for the railroads' choice of parent holding companies as instruments for their diversification. It stems from a 1913 investigation of, among other things, the New Haven Railroad's financial problems (No. 4845, New England Investigation, 27 ICC 560).

". . . The outside financial operations of the New Haven for the last nine years," the Commission said in that report, "have been wasteful in the extreme, and . . . the methods by which those operations have been conducted are unnecessarily involved and complex.

"The present management started out with the purpose of controlling the transportation facilities of New England. In the accomplishment of that purpose, it bought what must be had and paid what must be paid. To this purpose and its attempted execution can be traced every one of these financial misfortunes and derelictions.

"Assuming that [the New Haven] had expended upon [its railroad property] the amount actually expended; that this money had been raised by the issue of stock and bonds in equal amounts, the bonds bearing that rate of interest which the New Haven has actually been compelled to pay; that the same amount of traffic had been handled (for, up to the present time, these outside operations have not added to the traffic of that road), and that the same rates had been charged, it appears that for the year ending June 30, 1912, that company could have paid a dividend of 8 per cent upon its stock and carried to surplus $1,794,000, instead of showing a deficit of $930,000. . . .

"The New Haven, within the last nine years, has materially advanced both its freight and passenger rates. There is no evidence to show the gross amount resulting from this increase, but it is probable that this company could have done business without any advance in its transportation charges, and have continued to pay its stockholders a dividend

of 8 percent, had it been content to confine itself to the mere operation of its railroad property. No more conspicuous examples can be found of the disastrous results which may flow from these outside operations."

The effect of these nine years of "outside operations" by the New Haven continued to haunt New England transportation for the next 56 years. Unable to cope with the fluctuations of the volatile railroad industry, the railroad went through two reorganizations in bankruptcy, and was on the verge of liquidation when its service was "saved" by an ICC requirement that it be included in the Penn Central system as of January 1, 1969.

"EVILS" OF DIVERSIFICATION

Even though it found, in 1913, no cause for "hysteria" in the New Haven's financial condition at that time, the Commission took a serious view of the problem. In its report on the investigation, it reached the following conclusion, which has forced rail management to be almost super-cautious in expansion efforts ever since:

"No student of the railroad problem can doubt that a most prolific source of financial disaster and complication to railroads in the past has been the desire and ability of railroad managers to engage in enterprises outside the legitimate operation of their railroads . . .

"The evil which results, first to the investing public and finally to the general public, cannot be corrected after the transaction has taken place; it can be easily and effectively prohibited. . . . *Every interstate railroad should be prohibited from expending money or incurring liability or acquiring property not in the operation of its railroad or in the legitimate improvement, extension or development of that railroad.*" (Emphasis added.)

Seven years later, in 1920, Congress enacted legislation to implement this conclusion. It gave the ICC veto power over a railroad's issuance of securities or assumption of any financial obligations and liabilities, and provided that, before approving any such action, the ICC *must* find that it "is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and . . . will not impair its ability to perform that service."

In later years, the ICC modified its stand somewhat. Another New Haven investigation case (New York, New Haven & Hartford Railroad Co., Investigation, 220 ICC 505) led the Commission, while reiterating that "the resources of a railroad ordinarily should be devoted to the proper development of its own transportation system," to add:

"If they [the railroad's resources] are to be invested in an outside activity, it should be after a finding that such investment constitutes a proper use of railroad funds or credit; that the terms of the transaction are reasonable; and that the investment is in the public interest."

The Commission concluded that restrictions imposed on railroad investment in non-railroad enterprises should not preclude "investments such as are permissible for savings banks and trustees." At the same time, however, the ICC extended its restrictive approach to the railroads' subsidiaries, thus approving only very limited diversification by the railroad industrial complexes.

In the early 1960s, however, two events occurred that completely altered this situation, and have together been responsible for the railroads' current move toward conglomerate form.

The first, and most significant, involved a small (557 total track miles) road serving northern Maine, the Bangor & Aroostook. Under the guidance of Nicholas Salge, president of the Punta Alegre Sugar Co., the B & A in rapid succession created the first of the modern conglomerate holding companies, the Bangor & Aroostook Co., and then merged its parent with Punta Alegre to form the present Bangor Punta Co.

To understand the importance of this move, the observer must remember that the Commission is empowered to impose both the securities provisions and certain reporting requirements (albeit in somewhat lessened form) on railroad holding companies, as well as on the railroads themselves. However, as a prerequisite to imposition of these obligations on the parent companies, the statute requires the ICC to first assert jurisdiction over the holding company's acquisition of control of the railroad, and it may not do so unless control of more than one carrier is involved.

In 1960, the B & A Railroad controlled the Van Buren Bridge Co., another carrier. The Commission, however, found that these two companies "are constituents of a single integrated system." It eschewed jurisdiction over the B & A Co., and, by extension, over Bangor Punta (T.W., Aug. 20, 1960, p. 83).

Thus, Bangor Punta is completely free from any ICC supervision of its activities, although its railroad subsidiary, of course, remains under Commission jurisdiction. The Commission's policy of sharply inhibiting railroad expansion into non-transportation endeavors, accordingly, was (and still is) inapplicable to Bangor Punta.

Two years later, in another context, the Commission issued a decision which financial analysts saw as virtually an open invitation to transportation firms to diversify. The landmark quality of this decision is indicated by the fact that five of the 11 ICC members dissented on the ground that the majority was proposing to vitiate, a single blow, the Commission's 48-year-old policy of antipathy toward such activities.

Before the Commission was an application of the Greyhound Corp. (at that time an active carrier, not the holding company it subsequently became) for authority to issue considerable amounts of stock. Purpose of the proposed issue was to allow Greyhound to gain

control of Boothe Leasing Corp., an industrial machinery leasing company not involved in transportation in any way; furthermore, Boothe insisted on a stock-exchange arrangement to protect its shareholders from tax liabilities, thus making the ICC's decision on the stock question determinative of the fate of the entire transaction.

The Commission approved the stock issuance in its report and order in Finance No. 21801, Greyhound Corp., Stock, 90 MCC 215 and, along the way, made a number of significant comments on transport diversification in general (T.W., March 31, 1962, p. 224):

"The proposed acquisition by Greyhound of Boothe is part of a diversification program designed to stabilize and increase its earnings, and thereby improve its ability to provide the public with common carrier passenger service by bus. . . .

"The prime objectives of sections 20a and 214 [of the interstate commerce act, which set forth the previously mentioned securities provisions] is the establishment of a soundly capitalized transportation industry, capable of adequate service at reasonable rates. Generally, it has been found that it is not compatible with the public interest for a carrier to issue securities, the proceeds of which are to be invested in property not to be held for, or used in, the service of transportation. . . ."

The Commission went on to note that in several past instances it had approved similar issuances by non-carrier holding companies which (unlike Bangor Punta) were subject to the securities provisions. However, it said, "in those instances in which management proposals for diversification appeared improvident, such proposals have been disapproved as not in the public interest."

"As a general rule," the majority concluded, "it is clear that the issuance by a carrier of securities, or the use of the proceeds from such issuance, generally should be authorized only in those instances where it would be of benefit to or enhance its carrier transportation.

"In no event should a carrier be authorized to issue securities or use the proceeds therefrom, or assume obligation or liability with respect to the securities of any other person, where it is not for some lawful object within its corporate powers; is not compatible with the public interest, and where it would impair in any respect the carrier's ability, financial or otherwise, to perform its service to the public as a common carrier. A carrier's major endeavors should continue to be confined to matters related to transportation, and no authorization should be granted where the effect of the issuance of securities, or assumption of obligations or liability, would materially affect the promotion of such major activity. . . .

"Judicious common-carrier investment in stable non-carrier business enterprises, if limited, would contribute to the provisions of a soundly financed common-carrier system, and would not do violence to the principle that corporations endowed with a public interest should direct their primary activities to the public-service nature of their operations."

The five dissident commissioners, led by Commissioner Kenneth H. Tuggle, argued that the majority was applying to Greyhound—a carrier—the standards properly applied only to non-carrier holding companies that had been subjected to ICC jurisdiction. In this respect, they argued:

". . . The intent of Congress as to holding companies was not, and could not have been, to preclude the non-carrier from issuing securities in furtherance of its non-transportation businesses, but only to insure that such issuance would not harm the carrier or carriers controlled by the holding company."

The minority concluded by saying, respecting the Greyhound-Boothe transaction:

"If this precedent is to be followed, adequate supporting evidence at least should be required to inform the Commission as to the non-carrier business concerned, its financial condition and accounting methods, so that it [the Commission] might make an educated appraisal of the 'judiciousness' of the investment as support for the new standard."

RAILS ACCEPT "INVITATION"

With the incentive of the Bangor Punta and Greyhound cases to spur them on, more and more railroad managements during the past few years have abandoned their traditional conservative attitudes to enter the conglomerate movement. Among others, the Illinois Central; the C & N W; the Katy; the Atchison, Topeka & Santa Fe; the Seaboard Coast Line; the Kansas City Southern; the Boston & Maine; the Union Pacific, and even the Penn Central, largest of all U.S. roads, have either already formed parents or have announced plans for such a step in furtherance of diversification programs.

For the most part, the ICC has followed its B & A precedent and has dismissed applications for authority to make the corporate changes on the ground that it lacks jurisdiction to consider them. *Two of the holding companies were found for various reasons to come within the Commission's purview:* however, in both cases (Illinois Central Industries and Northwest Industries), the Commission has limited its supervision of these firms' activities to *imposition of minimal reporting requirements.*

Within the past two months, however, three separate events have brought considerable pressure to bear on the ICC to at least review its noninterference policy respecting these conglomerate activities. Perhaps unfairly, the C & N W and Northwest Industries have been singled out for special attention in all three cases.

After concluding that the proposed C & N W-Milwaukee merger should be approved. Hearing Examiner Darmstadter urged the Commission to make a complete investigation of the conglomerate question. In particular, he said. *Northwest Industries should at the least be required to file more complete reports of its activities with the ICC.*

The same position respecting Northwest Industries' reports was taken by the Commission's Bureau of Enforcement in a brief filed in connection with the complex Rock

Island control cases. In that brief—in which it declined to review the merits of the rival applications, including that of the C & N W, for authority to take control of the Chicago, Rock Island & Pacific Railroad—*the bureau* suggested that any approval of the C & N W's application be *conditioned on subjection of Northwest Industries to more extensive reporting requirements* (T.W., Feb. 1 p. 75, and Feb. 8, p. 73).

Significantly, neither Examiner Darmstadter nor the Bureau of Enforcement made any mention of the securities provisions of the interstate commerce act. The B. F. Goodrich Co., however, devoted an entire petition to this subject, arguing that Northwest Industries should be required to seek Commission approval of any securities issuance or any assumption of obligation or liability respecting others' securities.

The petition was filed by Goodrich after Northwest Industries announced that it is attempting to take over the company. Goodrich's management is opposed to any such takeover, and avowedly used its petition to the ICC as a vehicle to further its opposition.

In its plea, Goodrich asserted that its acquisition by Northwest Industries would raise Industries' indebtedness by several hundred million dollars. It suggested that this might result in a significant weakening of Industries' financial position—and, through Industries, of the C & N W Railway's financial position—and urged the ICC to take jurisdiction to insure that such a result would not obtain (T. W., Feb. 1, p. 16).

Replying to the petition, Northwest Industries asserted that it is perfectly capable of absorbing the additional obligations attendant to the proposed Goodrich takeover. It warned the ICC that any enforcement of the securities provisions of the act on it, or on any of its fellow railroad "parents," would have an enormously detrimental effect on their diversification programs.

"The delay that would attend a section 20a proceeding [in connection with securities issuance] would deprive Industries and all similarly situated companies of any hope of successfully competing for the acquisition of non-transportation companies," it said. "The purpose and effectiveness of all railroad holding companies created in recent years to bring to the transportation industry the benefits of diversification would be destroyed" (T.W., Feb. 8, p. 58).

In this statement, Northwest Industries struck at the heart of the conglomerate controversy. Virtually no one—and certainly no responsible person—is seeking to block all railroad expansion beyond the transportation industry. There are, however, many who are fearful that untrammeled expansion could bring railroads more trouble than benefits.

In his recent article discussing the financial aspects of the railroads' diversification programs, Mr. Roth pointed out some of the pitfalls in this course of action. Diversification, he said, "will be more difficult than the first blush of initial expectations would indicate."

"Rail management," he continued, "is on the whole inexperienced in the highly competitive and sophisticated acquisitions business. Companies which have led the way in diversification have principally been managed by lawyers or investment bankers, as opposed to traditional railmen. Also, most managements have little ownership in their companies, and therefore may have limited entrepreneurial incentive to take risks or make aggressive moves."

DETRIMENTAL POSSIBILITIES

Opponents of unregulated rail diversification amplify on this topic by contending that creation of the conglomerate holding companies could afford a perfect opportunitiy for the "milking" of a railroad. *A holding company, they say, might "siphon off," via intercorporate transactions, most of the wealth and disposable non-transportation assets (such as real estate, etc.) of the railroad—and then cast it adrift to fend for itself with greatly depleted resources.*

Another possibility, they continue, requires no nefarious conduct by the management, but only poor judgment. It is entirely possible, they say, that inexperienced railroad men might enter into a series of ill-advised transactions which could dissipate the conglomerate's—and, through it, the railroad's—assets to the point where serious financial problems might arise. It is precisely this argument that was raised by Goodrich in its opposition to Northwest Industries' takeover attempt.

Even relatively experienced managements in the conglomerate field have, on occasion, run into financial problems in connection with expansion. Often, the conglomerate opponents say, over-ambition is the cause. In its rush to diversify, a company may "bite off more than it can chew" in terms of obligations, and be forced to undergo extensive retrenching in order to right itself.

In this connection, the opponents cite the case of DC International, Inc., one of the nation's largest trucking firms. Problems attendant to its expansion efforts produced considerable publicity at the time, and resulted in minor changes in its managerial set-up (T.W., July 30, 1966, p. 25). The eventual fate of the company was its merger with two other major trucking firms to create the new T.I.M.E.-DC, Inc., under the control of National City Lines (T.W., Jan. 4, p. 31).

Another fear expressed by opponents of the conglomerate scheme in its present format is that the parent holding companies may become so large, and so diversified, that the operations of its railroad subsidiary may suffer from inattention, if nothing else. A railroad's principal duty, they say, is to transportation, not to a complex multi-business conglomerate structure.

Bangor Punta, these opponents argue, has already gone much of the way toward this situation. This company—"dean" of the modern conglomerates—now owns about 20 companies, only one of which (the B & A) is engaged in railroading. It had total sales in 1968

of about $258 million, and the 1969 prediction is for nearly $100 million above that amount; of this, the railroad's total contribution was a $100,000 profit. Bangor Punta spokesmen rank the company first in the nation in manufacture of public security equipment, and second in boatmaking; the B & A, of course, occupies nothing like a comparable position in the rail industry.

These arguments are at least somewhat vitiated, however, by the absence of any serious complaints about B & A service. In fact, it can be argued with some justice that B & A service is better because of the capital available for its activities from Bangor Punta—capital which the small road itself, standing alone, could not generate.

Delving somewhat into the realm of the hypothetical—since the short history of rail conglomerate operations leaves a paucity of actual examples—the opponents suggest that future problems might arise if one of the conglomerates acquired a highly "capital-intensive" company (i.e., one requiring a high level of capital investment for optimum performance). Such a firm, they say, would stand as a great incentive for the conglomerate to divert into its operations, rather than to the less profitable railroad activities, available capital funds.

Rail financial analysts retort that there are very few industries more "capital-intensive" than railroading, which requires a considerable level of annual investment simply to maintain a consistent level of service, without regard to improvements. They find it more likely that the capital generated by the conglomerate's non-transportation subsidiaries will be channeled into the railroad, rather than the other way around.

Furthermore, they add, normal business acumen also provides a measure of insurance against injury to the railroad as a result of conglomerate activities. For various tax reasons, even an unprofitable railroad can be, in the hands of an otherwise viable conglomerate, a very valuable property, and the conglomerate can be expected to treat it as such.

"There are three principal tax advantages," said Mr. Roth in his analysis of the railroads' diversification. "None but a handful of the strongest roads can fully utilize investment tax credits generated by high capital expenditures relative to revenue. Unless rail earnings improve, acquired earnings can be sheltered to the limit of the credit. Also, many companies have large investment credit carry-forwards to apply.

"Poorer roads have the option of adopting fast depreciation lives and procedures to road and equipment accounts whenever sufficient earnings are created to justify the shelter. Large abandonment credits on non-depreciable property are another important tax shelter, particularly where mergers release duplicable facilities.

"These tax advantages will generate tax savings of roughly $500 million for Penn Central and $250 million for Northwest Industries, depending in part on future equipment purchases. In the case of Katy and Boston & Maine, there are also large but perishable operating carry-forward losses which could well be used to shelter acquired earnings."

For all of these incentives to the conglomerates to preserve and protect their rail subsidiaries, even the most outspoken of the diversification advocates admit there can be no guarantee that they will operate perfectly. And it is just this lack of a "guarantee" that forms the crux of the arguments of pro-regulation spokesmen respecting the conglomerates.

PUBLIC UTILITY STATUS

A railroad, they say, is on an entirely different level from the normal, self-regulating (through competition, as enforced by federal antitrust statutes) business. The inherently monopolistic nature of the industry, coupled with the public-service character of its operations, give it a public-utility status as well, just as similar (although not identical) factors bestow the same status on telephone companies, power firms, etc. And the purpose of regulating utilities, they say, is to provide, as much as is feasible, a "guarantee" of continued (and, if possible, improving) service.

As a utility, these spokesmen point out, the railroads have a number of advantages under the provisions of the interstate commerce act. Such things as price-fixing—anathema in other industries—are specifically permitted in the form of "collective rate-making" for railroads, subject to ICC supervision. The Commission also affords existing companies protection against deterioration in their competitive situation through mergers of other railroads, or through entry of late-comers into the industry. Numerous other advantages, they say, accrue to the railroads from regulation.

As a result of the 1913 New Haven investigation, the Commission formed its policy—subsequently given a congressional stamp of approval—that one of the prices railroads must pay for these advantages is regulation of their financial activities, the conglomerate detractors continue. Yet today, they argue, the railroads are balking at paying this price while still retaining all of their regulatory advantages.

The "horrible example" of the New Haven is still staring the ICC in the face, these opponents say. The Commission has never reversed the policy it formed in that 56-year-old investigation, they add; in fact, the recent Greyhound-Boothe decision served to reinforce that policy, although approving "limited" and "judicious" carrier investments outside the field of transportation.

Under these circumstances, they conclude, it is quibbling for the ICC to take a "hands-off" attitude toward the modern conglomerates simply because corporate restratification removes diversification activities one step from the railroad company itself. They argue that a repetition of the 1913 New Haven situation is not precluded simply because it is the railroad's parent, rather than the railroad itself, that is participating in the actual business transactions.

The New Haven analogy, the proponents of diversification contend, is hopelessly inapposite today. The economy has changed almost beyond recognition since 1913, they argue, and these changes are ample to forestall any recurrence of this situation. Stricter antitrust statutes, careful enforcement of these statutes by the U.S. Department of Justice, and the regulatory influence of the Securities and Exchange Commission provide ample governmental protection against such a problem, they say.

They also question the ICC's competence to regulate the activities of the parent conglomerate firms, which touch on transportation—the area of the Commission's expertise—only peripherally. The activities of the railroads, they say, are painstakingly divorced from the operations of the parent companies, and regulation of the parents would lead the Commission into the forests of business finance, in which it is not credited with possession of any particular expertise. This view was also implicit in the five-member dissent to the Commission's Greyhound-Boothe decision.

OTHER PROBLEMS

The financial problems, say opponents of the rail conglomerates, are only one aspect of the problems deriving from this type of diversification. Another difficulty arises from the "commodities clause" in section 1(8) of the interstate commerce act.

This section prohibits railroads from transporting "any article or commodity, other than timber and the manufactured products thereof, manufactured, mined or produced by it [i.e., the railroad], or under its authority, or which it may own in whole or in part, or in which it may have any interest, direct or indirect, except such articles or commodities as may be necessary and intended for its use in the conduct of its business as a common carrier."

This clause was originally enacted in the first few years of this century to prevent flagrant favoritism by the railroads, who were gaining marketing advantages for their own traffic by abusing their transport duties. After a flurry of early cases on the topic, the clause has become more or less dormant in terms of cases prosecuted.

The modern conglomerates, however, could at one time revitalize the clause and make it virtually impossible to police, say opponents of the diversification movement. Court and ICC decisions have held that applicability of the clause in parent-subsidiary corporate situations depends on the "intimacy" of the interrelationship between shipper and carrier, a factor exceedingly difficult to determine. Furthermore, they say, failure of the ICC to assume any jurisdiction, even for reporting purposes, over the conglomerates means that the Commission might not even know when possible violations of the commodities clause were taking place, because of its lack of information about the railroad's nontransportation affiliates.

Considerable public furor has been raised recently as to the ownership of the nation's railroads, the opponents add. Ownership of a rail subsidiary by a conglomerate holding company, or course, is not in doubt—but ownership of the holding company itself may be. And, the opponents say, the Commission's considerable powers to study ownership of the railroads (T.W., Sept. 16, 1967, p. 101) are inoperative respecting the parent holding companies, unless these companies are subjected to ICC reporting requirements.

The railroads have at least a partial rebuttal to this point available to them as a result of the recent activities of Illinois Central Industries. In connection with the Illinois Central Railroad's proposed merger with the Gulf. Mobile & Ohio, opponents to the merger have once again questioned the possibility that the Union Pacific Railroad may, through its heavy stock interest in ICI, control the IC Railway, ICI was able to show, however, that its recent merger with the Abex Corp., a non-transportation firm, resulted in considerable dilution of the UP's stock interest and thus diminution in the UP's putative opportunity to exercise control over the IC Railroad (T.W., Feb. 8, p. 68).

Thus, while virtually all concerned can agree on the merits of the railroads' recent diversification moves, there is considerable diversity of opinion as to the methodology of this diversification. Opponents urge that the problem is much too complex, and involves far too many harmful possibilities, for the perfunctory treatment accorded it so far by the Commission. At the very least, they say, a full-scale ICC investigation should be instituted to determine whether, and to what extent, the conglomerates should be subjected to regulation.

Support for this viewpoint was recently advanced by Representative Keith (R-Mass.), a leading member of the House interstate and foreign commerce committee. It was perhaps significant that the congressmen's action followed hard on the heels of the Penn Central's announcement of its plans for creating a parent holding company.

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Representative Keith introduced in Congress a resolution calling for a multi-agency investigation to resolve some of the conglomerate questions—an investigation that would cover not only transportation, but all other regulated industries as well.

Participants in the probe envisioned by the Massachusetts congressman would be, in addition to the ICC, the Civil Aeronautics Board; the Securities and Exchange Commission; the Federal Trade Commission; the Federal Power Commission, and the Federal Communications Commission. The agencies would be directed to examine the "effects of conglomerate activities on the transportation and communications industries, the securities markets, and interstate and foreign commerce" (T.W., Feb. 1, p. 91).

Following Representative Keith's proposal, Chairman Staggers of the same House committee announced that his unit will make its own investigation of the conglomerate problem. Purpose of the investigation, he said, is to determine "whether a railroad or other carrier which is acquired by a person that is not a carrier can fulfill its obligations and responsibilities to the public in providing the kind of service that a common carrier is charged with providing the public (*see story elsewhere in this issue*).

There also remains the possibility that the ICC may act independently, either to institute a separate investigatory proceeding or to utilize some pending case (such as the C & N W-Milwaukee merger case, in which Examiner Darmstadter made his recommendation) as a vehicle for such a study. Meanwhile, however, for good or ill—and there is much to be said on both sides—rail conglomerate activities are expected to accelerate as more roads adopt this course in the future.

Exhibit 42

[Memorandum of B. Cole, Vice President Administration, and Executive Assistant to Chairman of Board, P.C.T.C., to S. T. Saunders]

Re Creation of a non-carrier parent for Penn Central.

It is suggested that action by the Board at its meeting tomorrow on the creation of a non-carrier parent is not advisable from the legal standpoint.

1. Action on this subject by the Board at tomorrow's meeting could be regarded as inconsistent with provisions of the other transaction to be approved. Such transaction has covenants applicable to Penn Central during the period between the signing of the merger agreement and consummating the merger, which prohibit changing the character of Penn Central's business and acquisition by Penn Central of its stock.

2. If Board action is taken, we would be obligated to disclose such action to the New York Stock Exchange and the public in accordance with the listing agreement of the Stock Exchange.

3. Pennsylvania Company and the Company it is acquiring in the transaction to be submitted to the Board tomorrow will each be soliciting shareholder approval pursuant to a proxy statement. (The consent of the holders of a majority of Pennsylvania Company's preferred stock is required.) Such proxy statements, because of S.E.C. regulations, would have to disclose any action taken by the Board to create a new parent for Penn Central. Such disclosure could create serious problems before the I.C.C., which Commission must authorize the new securities to be issued in connection with tomorrow's acquisition.

Although there are several important questions relating to creation of a parent corporation to be reviewed with the I.C.C. staff, it is recommended that such discussions not take place until the proposed Pennsylvania Company acquisition is accomplished. This would eliminate the danger that discussions with the I.C.C. staff may adversely affect the Pennsylvania Company acquisition. I.C.C. approval of the acquisition is not required; but since I.C.C. must authorize the issuance of new Pennsylvania Company stock, it will, as a practical matter, pass upon the terms and form of the acquisition.

It is recomended that we proceed at this time with an internal review and studies of procedures and problems in connection with creating a parent for Penn Central. This will place us in a position to move off promptly in whatever way is determined to be appropriate after the Pennsylvania Company acquisition has been completed.

Exhibit 43

[Memorandum of E. K. Taylor, P.C.T.C. legal department]

June 5, 1968.

Re Diversification by Penn Central.

David C. Bevan: The purpose of this memorandum is to point out that Penn Central Company as presently constituted is not a suitable corporation for the purpose of carrying out a large-scale program of corporate diversification and to discuss the creation of a corporation which would acquire control of Penn Central Company.

A. THE I.C.C. IS RELUCTANT TO PERMIT DIVERSIFICATION BY A RAILROAD

Penn Central, as an operating railroad, must obtain the approval of the Interstate Commerce Commission pursuant to section 20a of the Interstate Commerce Act prior to the issuance or guaranty of any securities in connection with a corporation acquisition. Although the Commission has approved the issuance of securities by carriers to carry out their corporate diversification, it has done so reluctantly and has indicated that it will limit the amount of securities a carrier may issue for non-carrier purposes. This reluctance of the Commission is particularly evident where the business being acquired is not related to the business of the carrier issuing the securities. It is clear that unless the I.C.C. reverses its prior decisions it is not feasible for a railroad to issue securities in the quantity which would be needed to carry out a major diversification program.

B. OTHER RAILROADS HAVE CIRCUMVENTED I.C.C. JURISDICTION OVER DIVERSIFICATION

The difficulty described above has been recognized by several railroads, such as the Bangor & Aroostook, Chicago & Northwestern, Illinois Central, Kansas City Southern and Santa Fe. They have created, or in the case of the Santa Fe are in the process of creating, non-carrier parents for their respective railroad corporations. In two of these cases; namely, the Bangor and Aroostook and Kansas City Southern, the I.C.C. held that it had no jurisdiction over the issuance of securities by the non-carrier parent; because the carriers controlled by it constituted a single integrated system. The parents of the other railroads previously named have followed, and will follow, this same path of issuing securities without having to obtain I.C.C. approval thereof.

The mechanics used normally consist of, (1) an exchange offer by a new corporation to the stockholders of the railroad which offer is accepted by the mailing of letters of acceptance by such stockholders, (2) when letters of acceptance are received for over 80% of the outstanding stock of the railroad, the accepting stockholders are notified to deposit their shares for exchange for stock of the new corporation and (3) if 80% of the shares are so deposited, the exchange offer is declared effective by the board of directors of the new corporation and the railroad has a parent company.

The stock of the parent company is listed on the New York Stock Exchange; the exchange is tax free to the holders of the stock of the railroad; no meeting of stockholders of the railroad is necessary to make the transaction effective since the charter and outstanding stock options of the railroad to be assumed by the new corporation before the exchange offer is made.

The new corporations controlling the Bangor and Aroostook, Chicago & Northwestern, etc., may issue securities in connection with the non-railroad corporate acquisitions without prior I.C.C. approval. Such securities must be registered with the Securities and Exchange Commission, and S.E.C. approved prospectuses must be used. This S.E.C. requirement will apply to the initial issuance of securities in exchange for the outstanding stock of the railroad. These parent corporations can, in my opinion, avoid regulation by the S.E.C. as holding companies.

C. I.C.C. PROBLEMS FACING PENN CENTRAL COMPANY

Assuming that a non-carrier corporation acquires control of Penn Central, there is a substantial legal question as to whether such parent corporation can issue its securities without prior I.C.C. approval. The question arises as follows:

1. Under Section 5(2) of the Interstate Commerce Act, Commission approval must be obtained before a non-carrier may acquire control of two or more carriers. When the I.C.C. approves such control, it may, but it not required to, subject the non-carrier to I.C.C. regulation, including Commission approval of its securities issues. Pennsylvania Company was subjected to I.C.C. jurisdiction in 1942 when it obtained authority to control Wabash Railroad Company in addition to Pennsylvania Railroad system carriers. However, I.C.C. has decided in the two cases mentioned in "B" that it will not retain jurisdiction over security issues of the parent corporation if the carriers controlled by it constitute a "single integrated system." In view of Pennsylvania Company stock control of Wabash and Lehigh Valley, the I.C.C. may determine that the new corporation will control more than a single integrated system of rail carriers and retain jurisdiction over the issuance of securities by the new corporation.

2. Even if the parent company is not subjected to I.C.C. jurisdiction over its security issues when it acquires control of Penn Central, the parent will have to file applications with the I.C.C. for authority to acquire control of additional railroads, due to the provisions of section 5(2) of the Interstate Commerce Act that non-carriers may not control more than one carrier without I.C.C. approval. The filing of such an application will afford to the I.C.C. an opportunity to take jurisdiction over security issues of the parent company, if it wishes to do so. This very issue is before the I.C.C. at this time in connection with an application of Illinois Central Industries to acquire control of the Gulf, Mobile and Ohio, and in connection with acquisition of control of the Chicago, Milwaukee, St.

Paul & Pacific by Northwestern Industries. The Penn Central parent will face the same problem if it acquires control of Penn Central before the latter acquires control of the assets of the New Haven Railroad. (It should be noted that the New Haven Trustees or the New Haven creditors may desire to have stock of the parent company in place of the 950,000 shares of Penn Central Company stock presently agreed upon.) It can also arise if the parent company will be acquiring direct or indirect control of New York, Susque hanna and Western Railroad Company.

It would be desirable to explore these problems informally with the I.C.C. staff to ascertain whether it would be legally possible to create a parent corporation for Penn Central Company which would be free of I.C.C. control.

D. I.C.C. WILL PERMIT DIVERSIFICATION BY NON-CARRIER PARENT CORPORATION

It should be noted that the I.C.C. will approve the issuance of securities by a non-carrier parent corporation to carry out a diversification program. Pennsylvania Company was able to obtain I.C.C. approval for the Buckeye acquisition. Greyhound Corporation, a non-carrier parent corporation, has been able to obtain I.C.C. authority to issue securities to carry out its diversification program. Although the terms of each proposed transaction must undergo I.C.C. scrutiny, the Commission so far has not indicated any intent to limit the amount of diversification to be undertaken by non-carrier parent corporations. However, in passing upon a proposed security transaction, I.C.C. must consider the "anticompetitive consequences" of the transaction. This I.C.C. jurisdiction will give to the Department of Justice a forum in which to raise antitrust issues. In doubtful cases the I.C.C. may not act promptly in order to give the Department of Justice ample time to come into the case. I.C.C. approval of a security issue does not confer immunity from subsequent prosecution for an antitrust violation, but it should lessen the likelihood of such a prosecution.

E. TIME ESTIMATES FOR ESTABLISHING A NON-CARRIER PARENT CORPORATION FOR PENN CENTRAL COMPANY

From a timing standpoint, if the I.C.C. does not have jurisdiction over the transaction and if the New Haven Trustees, or other persons, do not interfere, I would estimate that the exchange of Penn Central stock for stock of a non-railroad corporation can be accomplished in approximately four months. This schedule allows six weeks to do preliminary legal work and to prepare and file a registration statement for an exchange offer, four weeks to clear the registration statement with the S.E.C. and make the exchange offer effective, and six weeks to solicit and carry out the exchange of stock.

If I.C.C. approval is necessary and the I.C.C. proceedings are not contested, the timing again would be about four months.

If it is desired to have the parent company free of I.C.C. jurisdiction, and the I.C.C., or the I.C.C. staff, desires to impose I.C.C. jurisdiction, the time period could be longer, depending upon what events take place

E. K. TAYLOR.

EXHIBIT 44

[Memorandum of B. Cole, Vice President Administration, and Executive Assistant to Chairman of Board, P.C.T.C., to S. T. Saunders]

JANUARY 20, 1969.

MR. SAUNDERS: Following, for your reference at the meeting at 10:15 this morning, is a list of the issues that are raised by the proposal to create a Parent Holding Company:

1. What are the reasons for creating a holding company and what functions will it perform?
   - (a) Greater availability of capitalizable assets, and
   - (b) More appeal to investors because non-railroad earnings direct to parent, rather than through railroad company. This also clarifies rate of return and other regulatory problems, and
   - (c) Other.
2. Will assets be transferred to the Parent Company?
   - (a) Real Estate companies;
   - (b) Buckeye;
   - (c) N&W stock;
   - (d) Park Avenue properties subject to mortgage;
   - (e) Other.
3. Certain legal and technical considerations—
   - (a) State of incorporation, Delaware or Pennsylvania?
   - (b) If Pennsylvania, will Business Corporation Law be adopted?

(*c*) What charter powers and capitalization?
(*d*) Will ICC or SEC have jurisdiction?
What is anticipated effect of Darmstadter's report concerning Northwest Industries, Inc?
(*e*) What will be the source of retained income—ability to pay dividends?
(*f*) Other.

4. Have names for new Parent and Railroad been researched and reserved?
5. Board of Directors of Parent—how many Directors?
(*a*) What effect will the Gilberts proposals as to classification and cumulative voting have? Also, proposed Stock Exchange rule on limiting classes of directors?
6. Will the holding company have an active management? If so, how will it be organized and staffed?

Basil Cole.

EXHIBIT 45

Form BF-6 — Form approved. Budget Bureau No. 60-R250.5

Before the

INTERSTATE COMMERCE COMMISSION

Washington, D. C.

APPLICATION UNDER SECTIONS 20a OR 214, INTERSTATE COMMERCE ACT, FOR AUTHORITY TO ISSUE SECURITIES, OR TO ASSUME OBLIGATION OR LIABILITY IN RESPECT OF SECURITIES OF ANOTHER PERSON

(Read General Instructions on page 8)

FINANCE DOCKET

No.

CAPTION

In the matter of application of:

A. State full and correct name and business address of applicant.

B. State whether applicant is a carrier by railroad, a common or contract carrier by motor vehicle, a corporation organized for the purpose of engaging in transportation as any such carrier, a sleeping-car company, or a holding company, as defined in the General Instructions, subject to the securities provisions, as provided in section 5(3) of the Act. Motor Carriers: State leading docket number.

C. Describe briefly the securities proposed to be issued or obligation or liability proposed to be assumed.

D. List the states in which the applicant carrier operates or is authorized to do business, or the applicant holding company is incorporated or authorized to do business.

E. Refer to related Finance proceedings, if any, pending (by Docket Number) or to be filed.

F. Furnish name, title and business address of the person to whom correspondence with respect to the application should be addressed.

To the INTERSTATE COMMERCE COMMISSION,
Washington, D. C.

The following statements and information, identified by numbers and letters corresponding to those used herein, are submitted by applicant in support of the authority sought:

Item 1. General information respecting applicant.

(a) Date and State of incorporation, or other organization.

(1) If applicant is incorporated or organized under the laws of, or authorized to operate in, more than one State, give all pertinent facts as to such incorporation or organization.

(2) If authorization to a new, reorganized, or consolidated corporation which is not in existence is sought, name the jurisdiction under the laws of which the corporation would be organized, reorganized, or consolidated.

(3) If applicant is a trustee, receiver, assignee, or other fiduciary, name the court, if any, under the direction of which applicant is acting, and state the nature of the proceeding, if any, in which the applicant was appointed.

(b) Subject to the rule regarding incorporation by reference, file with the original application, but not with the copies, one or more of the following documents as may be appropriate:

(1) Copy of charter or articles of incorporation, with amendments to date, duly certified by the appropriate public officer; and copy of bylaws, with amendments to date.

(2) If applicant is not a corporation, copy of articles of agreement, or association, or trust agreement, evidencing organization.

(3) If applicant is a trustee, receiver, assignee, or other fiduciary, copy of duly certified order of the court, or instrument of appointment.

Item 2. Financial statements.

(a) Applicant's general balance sheet as of the latest practicable date.

(b) If applicant is a carrier by motor vehicle, a corporation organized for the purpose of engaging in transportation as such carrier, or a motor-carrier holding company, and the value (fair market value as of date of issue, or par value, whichever is greater) of its capital stock outstanding as of the date of said balance sheet alone does not exceed $1,000,000, furnish a statement showing as of said date the extent to which its liabilities other than capital stock are or are not represented by notes or other securities, and description thereof.

(c) Applicant's income and profit and loss statement for the last calendar year, unless such copy is on file with the Commission in its annual report or another proceeding to which reference is made, and a copy of such statement for the current calendar year to the latest available date.

Item 3. General description of the securities with respect to which the application is made.

(a) If the application covers the issue of stock, the description should include:

(1) The kind and class of stock, (2) the number of shares authorized, outstanding and to be issued, (3) par value of each share and/or stated value, if having no par value, (4) amount, (5) voting rights, (6) preferences, (7) conversion privileges, (8) call provisions, (9) liquidation rights, and (10) whether it is assessable.

(b) If the application covers the issue of securities other than stock, the description should include:

(1) Full title of the securities, (2) title and date of the indenture, if any, under which the securities are to be issued and the name of the trustee or trustees under the indenture, (3) principal amount authorized, previously issued, and proposed to be issued under the indenture, (4) denominations of the securities to be issued, (5) date of the securities, (6) interest rate or rates, (7) interest payment dates, (8) date or dates of maturities, with amounts maturing on each date, if maturing serially, and (9) reference to provisions of the indenture, if any, under which the securities will be issued, permitting the proposed issue of securities thereunder, and relating to sinking funds, redemption features, and conversion rights.

(c) Specimens, or forms where specimens are not available, of all securities with respect to which the application is made.

(d) In case of the issue or assumption of bonds or evidences of indebtedness, a copy of the mortgage or indenture by which secured or proposed to be secured.

Item 4. Purposes of the proposed issue or assumption, and uses of the proceeds.

Statement showing with respect to one or more of the purposes specified below, the amount of the net proceeds intended to be used for such purpose, also:

(a) The acquisition of property other than equipment: A statement containing--

(1) A general description of the character, size, and location of the property, and the name and address of the person from whom it is to be acquired; and

(2) The actual or estimated costs to applicant of acquisition of the property, classified by Interstate Commerce Commission primary accounts; full terms of the contract, if any has been made, for such acquisition; and data necessary for a determination of the reasonableness of such costs.

(b) The acquisition of equipment: A statement containing--

(1) A full description of the equipment by type or design of unit, size, capacity, builder, year built, and name and address of the person from whom it is to be acquired.

(2) The unit prices paid or to be paid free on board builder's plant; whether the equipment was purchased through competitive bidding; and, if the unit prices shown are not the lowest bids received, the reason for accepting a higher bid.

(c) The construction, completion, extension, or improvement of facilities, or additions and betterments thereto by a common carrier by railroad (accomplished expenditures or expenditures not yet made): A statement showing--

(1) The period covered by the expenditures.

(2) The purposes of the expenditures.

(3) The amount of proposed expenditures or expenditures made but not yet capitalized and credits by reason of retirements within the period.

(4) The distribution of the total cost by the primary accounts of the Commission's classification of investment in road and equipment.

(d) The discharge or refunding of existing obligations (including notes maturing not more than two years after the date thereof, issued under paragraph (9) of section 20a or the $200,000 exemption applicable to such notes under section 214): A statement containing a full description, together with terms and conditions (including discounts and commissions, counsel fees, and all other expenses) of sale or other disposition of such existing obligations.

(e) The reimbursement of money expended from income or from other monies in the treasury of the applicant (including proceeds of notes maturing and issued as described in the preceding paragraph), not yet capitalized: A statement showing--

(1) The period covered by the total disbursement.

(2) The purposes of the disbursements.

(3) The amount of disbursements (gross capital charge) and all credits to capital account within the period.

(4) The primary accounts of the Commission's classification to which the disbursements or retirements were charged or credited.

(f) Other purposes: A statement containing complete details of the purposes of the proposed issue or assumption.

Item 5. The facts and circumstances on which the applicant relies.

(a) If the applicant is a carrier or corporation organized for the purpose of engaging in transportation as a carrier--

To establish that the proposed issue or assumption (1) is for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common (or motor contract) carrier, and which will not impair its ability to perform that service, and (2) is reasonably necessary and appropriate for such purpose.

(b) If the applicant is a non-carrier person, which is authorized by an order entered under section 5(2) of the Act to control a carrier or carriers--

To establish that the proposed issue or assumption is consistent with the proper performance of its service to the public by each carrier which is under the control of such person, and will not impair the ability of any such carrier to perform such service, and is otherwise consistent with the public interest.

(c) If the application is filed with respect to a class of railroad securities as to which competitive bidding is prima facie required,[1] and exemption from such requirement is sought--

To show that competitive bidding should not be required in the sale or other disposition of the proposed securities, including a statement that applicant has not entered into any discussion or any negotiations with respect to the terms of sale with any prospective purchaser of its securities.

(d) If the application is to sell railroad securities without competitive bidding on the ground that such securities come within one of the specific exemptions--

To show that the exemption applies

---

[1]Pertinent conclusions and the requirements are set forth in the Commission's report, In Re Competitive Bidding in Sale of Securities, 257 I.C.C. 129, as modified by findings in Atlantic Coast Line R. Co. Competitive Bidding Exemption, 282 I.C.C. 513, and further modified In Re Competitive Bidding in Sale of Securities, 307 I.C.C. 1.

Item 6. Terms of sale or other disposition, and estimate of expenses.

(a) At what price or prices, rate or rates, and upon what terms and conditions it is proposed to sell or otherwise dispose of the securities.

(b) An estimate of the expenses to be incurred by applicant in connection with such sale or other disposition, itemized to show--

(1) The commissions to be paid, discounts to be allowed, and the total of commissions and discounts.

(2) Legal expenses, accounting expenses, engineering expenses, expenses for certification, expenses for authentication, other expenses, and the total expenses. Where the amounts of the items grouped under "other expenses" are relatively substantial, they should also be itemized under that general item.

(3) The grand total of commissions, discounts, and expenses.

Item 7. Contracts, underwritings, and other arrangements.

How and to whom, and by or through whom, it is proposed to issue the securities, with details of all contracts, underwritings, and other arrangements made or proposed to be made in connection with the issue.

Item 8. Resolutions and other authorizations.

(a) Copies of all resolutions of directors authorizing the proposed issue of securities or the proposed assumption of obligation or liability for which authority is requested.

(b) If the charter or bylaws require approval by stockholders, copies of resolutions of stockholders, authorizing such issue or assumption, all such resolutions of stockholders to be accompanied by sufficient transcripts of the minutes of their meetings to show the number of shares voted for and against the resolutions, and the number of share-votes required to adopt the resolution.

(c) Copies of resolutions of stockholders or directors, or duly authorized committee thereof, authenticated by a proper executive officer of applicant, designating by name and for that purpose the executive officer by whom the application is signed, verified, and filed on behalf of the applicant.

(d) If applicant is an association or other organization except a corporation, documentary evidence showing authorization of the proposed issue or assumption and designation of the individual signing, verifying, and filing on behalf of applicant; and

(e) If applicant is a trustee, receiver, assignee, or other fiduciary, a certified copy of the order, if any, of the court having jurisdiction, authorizing the proposed issue or assumption, and the filing of the application.

Item 9. Opinion of counsel.

That the issue or assumption with respect to which the application is made meets the requirements of the law as set forth in Item 5, and will be legally authorized and valid if approved by the Commission, with specific reference to any specially pertinent provisions of charter or articles of incorporation or association.

WHEREFORE, Applicant prays that the Commission enter an order under sections 20a or 214 of the Interstate Commerce Act authorizing the proposed issue or assumption as described in the application.

Dated this ____________ day of __________________, 19___.

____

By________________________

Title_____________________

OATH

County of______________________)ss:
State of_______________________)

________________________________, being duly sworn,
(Name of official)

states that he is the ____________________ of __________________;
(Title of official) (Name of applicant)

that he is authorized on the part of said applicant to sign and file with the Interstate Commerce Commission this application and exhibits attached thereto; that he has carefully examined all of the statements contained in such application and the exhibits attached thereto and made a part thereof; that he has knowledge of the matters set forth therein and that all such statements made and matters set forth therein are true and correct to the best of his knowledge, information, and belief.

____
(Signature of affiant)

Subscribed and sworn to before me, a ___________________ in and for the State and county above named, this ______day of ______________________, 19___.

(SEAL) ______________________________

My commission expires___________________________.

Form BF-6 Page 8.

CERTIFICATE OF SERVICE

________________________________certifies that upon the

_______day of__________________, 19___, a copy of the foregoing application was mailed or delivered in person to the Governor and Public Service Commission or other appropriate authority of each State in which the applicant operates or is authorized to do business, or in the case of holding companies, of each State in which the applicant is incorporated or authorized to do business, as follows:

____

____

____
(Signature)

____
(Date)

GENERAL INSTRUCTIONS

1. Use of Form BF-6. All carriers and other persons subject to sections 20a and 214 of the Interstate Commerce Act making application for authority (a) to nominally issue securities, (b) to sell, pledge, repledge, or otherwise dispose of securities nominally issued or assumed or nominally outstanding, (c) to actually issue securities, or (d) to assume any obligation or liability as lessor, lessee, guarantor, endorser, surety, or otherwise in respect of the securities of any other person, natural or artificial, actually outstanding, shall make such application substantially in the form of application designated Form BF-6.

2. Definitions. (a) The term "carrier" includes a common carrier by railroad (except a street, suburban, or interurban electric railway which is not operated as a part of a general steam railroad system of transportation) which is subject to part I of the Act, a common or contract carrier by motor vehicle subject to part II, a corporation organized for the purpose of engaging in transportation as any such carrier, and a sleeping-car company which is subject to part I.

(b) The term "holding company" means a person which is not a carrier, but which is authorized by an order entered under section 5(2) of the Act to control a carrier or carriers and, as provided in section 5(3), is to be considered a carrier subject to the provisions of sections 20a or 214.

(d) The terms "nominally issued", "nominally outstanding", "actually issued" and "actually outstanding" are used herein as they are defined for purposes of Railroad and Motor Carrier Uniform Systems of Accounts and Annual Reports.

3. Application of general rules and regulations. Before undertaking the preparation of the application, reference should be made to the rules and regulations governing the filing of applications under sections 20a and 214, and list of forms, published in the Code of Federal Regulations as Title 49, Part 51.

PENNSYLVANIA CO.

Dividends Declared on 4.625 Percent Cumulative Preferred Stock—Period: January 1, 1964 to December 31, 1970

Year:	Dividends
1964	$1,529,785
1965	3,267,542
1966	3,264,778
1967	3,264,779
1968	3,264,441
1969	$3,264,305
1970	1,632,152
Total	19,487,782

NORFOLK & WESTERN RR. CO.—STOCK (COMMON), INVESTMENT ANALYSIS

OWNED BY PENNSYLVANIA RR. CO.

[Par $100 per share]

Date	Acquired by—	Shares	Par value	Book value	
May 21, 1900	Kuhn Loeb & Co.	50,000	$5,000,000	$1,471,747.39	
Do	do	50,000	5,000,000	1,855,174.98	
Do	do	50,000	5,000,000	1,890,730.48	
Do	do			2,091.79	Interest.
Do	do			Cr. 680.44	Do.
June 13, 1900	N.C. Ry. Co. stock	Cr. 10,000	Cr. 1,000,000	Cr. 351,900.00	To N.C. Ry. Co.
June 27, 1900	P. Ft. W. & C. Ry. Co. guaranteed surplus stock	Cr. 15,000	Cr. 1,500,000	Cr. 525,450.00	To Pennsylvania Co.
Dec. 13, 1901	Transfer a/c	76,900	7,690,000	4,316,047.39	
Dec. 20, 1901	Cash	1,400	140,000	80,779.78	
Sept. 4, 1906	Kuhn Loeb & Co. a/c purchase B. & O.	Cr. 140,840	Cr. 14,084,000	Cr. 12,253,080.00	Sold to Kuhn Loeb & Co.
Sept. 29, 1906	Sundries			6,199,286.68	Profit on sale of stock to Kuhn Loeb & Co.
Apr. 21, 1909	Kuhn Loeb & Co.	133,940	13,394,000	11,839,378.35	
Dec. 13, 1909	Cash, K.L. & Co.	15,308	1,530,800	1,536,540.50	
Do	Special deposits (open market)	18,300	1,830,000	1,812,250.00	
Jan. 3, 1910	Cash, H. C. Frick	50,000	5,000,000	5,000,000.00	
Jan. 5, 1910	Cash, Adams Express Co.	11,600	1,160,000	1,160,000.00	
Jan. 12, 1910	do	25,000	2,500,000	2,500,000.00	
Nov. 29, 1911	N. & W. Ry. Co. bonds	8,240	824,000	803,167.25	
Sept. 12, 1912	do	47,881	4,788,100	4,788,100.00	
July 22, 1913 to Dec. 24, Cash		Cr. 17,350	Cr. 1,735,000	Cr. 1,830,701.00	Outside (a) 16,700 shares; Cumb. V.R.R. (b) 500 shares; Susq. C. Co. (c) 150 shares — 17,350 shares.
Nov. 14, 1913	Cash, New York stock tax			10.00	
Nov. 18, 1913	do			3.00	
Dec. 29, 1913	Cash (from N.C. Ry. Co. Insurance Fund)	905	90,500	92,762.50	
Do	Cash, New York State tax			18.10	
Do	Insurance fund	6,000	600,000	615,000.00	
Do	Trustees P.RR. employee savings fund	3,000	300,000	307,500.00	
Dec. 31, 1913	N. & W. convertible bonds	7,450	745,000	763,625.00	
		372,734	37,273,400	32,072,401.75	
Jan. 19, 1914 to Feb. 27, Cash		Cr. 27,500	Cr. 2,750,000	Cr. 2,870,764.00	
Mar. 14, 1914	Cash, transfer tax			44.00	
Mar. 10, 1914	M. & W. Ry. Co. bonds	2,200	220,000	225,500.00	
Mar. 16, 1914	do	25,300	2,530,000	2,593,250.00	
Mar. 30, 1914	Cash, transfer tax			56.00	
Sept. 30, 1914	N.C. Ry. Co. loan a/c	13,000	1,300,000	1,267,500.00	
Apr. 30, 1917	Sundries a/c merger H.P. Mt. J. & L. RR.	20	2,000	2,422.50	
Jan. 22, 1919	Cash			Cr. 270,027.60	Amounts received from sale of warrants covering privilege of subscription to N. & W. Ry. Co. bonds.
Do	P. & L. miscellaneous credit			270,027.60	
Dec. 31, 1919	CVRR Co. a/c acquisition of property	1,823	182,300	198,707.00	
Oct. 31, 1924	Trustees P.RR. employee savings fund	3,450	345,000	422,193.75	Received account liquidation of PRR employee savings fund.
Do	By insurance fund	Cr. 3,450	Cr. 345,000	Cr. 422,193.75	Sold to insurance fund.
Dec. 31, 1924	Interest accrued on investments	29,405	2,940,500	1,834,542.00	Received in payment of extra dividend of 10 percent on stock Pa.
Jan. 20, 1925	K.L. & Co. a/c purchase of N. & W. Ry. Sec.	27,700	2,770,000	3,448,510.25	
Jan. 27, 1925	N. & W. Ry. Co. bonds	2,300	230,000	238,630.00	Bonds surrendered and stock received—Placed on books at cost of bonds—9,000 bonds purchased Oct. 10, 1913 for $9,450 converted into stock.

Jan. 20, 1926	Del. RR. Co. construction	90	9,000	13,938.75	Received in payment of advance for construction—S.F. No. 2 at this value.
July 19, 1926	Cash (from N.Y.P. & N.RR. Co.)	60	6,000	9,180.00	
Nov. 1, 1926	Special Dep. & interest accrued on investment	118,600	11,860,000	17,597,564.00	Purchased from Kuhn Loeb & Co.
Nov. 26, 1926	Pennsylvania Co.	2,500	250,000	410,000.00	Purchased from Pennsylvania Co.
Dec. 20, 1927	Cash (N.Y.P. & N. sinking fund)	5,288	528,800	1,004,720.00	Purchased from N.Y.P. & N. RR. Co. sinking fund.
July 19, 1928	Pennsylvania Co. common stock	Cr. 357,000	Cr. 35,700,000	Cr. 41,781,907.80	Sold to Pennsylvania Co. at cost to PRR—Pennsylvania stock received.
Dec. 28, 1928	B.C. & A. Ry. Co. loan a/c	40	4,000	7,400.00	Received from B.C. & A. Ry. Co. in payment of advance—Bonds purchased Oct. 17, 1913 for $4,120.00 converted into stocks.
Feb. 17, 1932	N. & W. Ry. Co. common stock	700	70,000	76,275.00	Purchased and sold.
Do	do	Cr. 700	Cr. 70,000	Cr. 80,922.00	
Do	P. & L. miscellaneous credit			4,647.00	
June 3, 1932	Cash (Delaware RR. sinking fund)	140	14,000	9,380.00	Common sinking fund, Delaware RR. Co. purchased 14,000 bonds for $14,700, converted into stock.
		216,700	21,670,000	16,326,074.45	
Sept. 8, 1947	Exchange of stock, $100 par for 4 shares, $25 par	866,800			
Dec. 28, 1954	Cash (to Pennsylvania Co.)	Cr. 2,858	Cr. 71,450	Cr. 53,816.00	
Dec. 21, 1959	do	Cr. 214,954	Cr. 5,373,850	Cr. 4,048,636.00	Sales to Pennsylvania Co. (profit $18,951,442).
1960	do	Cr. 369,491	Cr. 9,237,275	Cr. 6,959,325.00	Sales to Pennsylvania Co. (profit $28,536,748).
1961	do	Cr. 48,526	Cr. 1,213,150	Cr. 913,982.00	Sales to Pennsylvania Co. (profit $4,086,019).
1962	do	Cr. 162,438	Cr. 4,060,950	Cr. 3,059,503.00	Sales to Pennsylvania Co. (profit $12,328,352).
1963	do	Cr. 51,345	Cr. 1,283,625	Cr. 967,078.00	Sales to Pennsylvania Co. (profit $5,033,005).
1963	To First Boston Corp	Cr. 17,188	Cr. 429,702	Cr. 323,734.00	(Profit $1,752,347).
June 27, 1900	Cash (P.RR. Co.)	15,000	1,500,000	525,450.00	
Dec. 31, 1900	Profit and loss			Cr. 225,450.00	Revaluation.
Nov. 29, 1911	N. & W. Ry. Co. convertible Bonds	7,800	780,000	780,000.00	Conversion of 780,000 N. & W. Ry. Co. Convertible 10–25 year. 4 percent bonds into stock.
Sept. 30, 1912	do	9,100	910,000	910,000.00	Conversion of $910,000 N. & W. Ry. Co. Convertible 10–25 year, 4 percent bonds into stock.
Mar. 22, 1913	Cash	5	500	512.50	
Dec. 31, 1924	Extra dividend on capital stock	Cr. 29,405	Cr. 2,940,500	Cr. 1,834,542.00	Payment of extra dividend of Pennsylvania Co. of securities owned to P.RR. Co.
Nov. 26, 1926	P.RR. Co.	Cr. 2,500	Cr. 250,000	Cr. 410,000.00	Sale to P.RR. Co.
Do	Profit and loss			254,029.50	Profit on sale to P.RR. Co.
July 19, 1928	Capital stock (P.RR. Co.)	357,000	35,700,000	44,625,000.00	Capital stock of this company issued in exchange for N. & W. Ry. Co. stock.
Jan. 14, 1932	Cash (outside)	5,200	520,000	437,120.00	
Feb. 15, 1934	Cash (P.RR. Co. insurance funds)	3,400	340,000	601,800.00	
Do	Cash (Susquehanna Coal Co.)	171	17,100	30,267.00	
Do	Cash (Bel. Del. sinking fund)	50	5,000	8,850.00	
Apr. 4, 1934	Cash (P.RR. Co. insurance fund)	1,700	170,000	297,500.00	
Apr. 9, 1934	do	5,300	530,000	938,100.00	
Aug. 16, 1934	Cash (outside)	4,000	400,000	675,000.00	
Apr. 4, 1935	do	2,400	240,000	359,450.00	
Apr. 12, 1935	Cash (postage due Apr. 4, 1935)			.32	
Oct. 8, 1937	Cash (outside)	100	10,000	20,730.28	
Oct. 22, 1937	do	1,000	100,000	180,250.59	
Mar. 15, 1938	do	200	20,000	33,058.30	
Mar. 16, 1938	do	200	20,000	33,058.00	
Mar. 17, 1938	do	100	10,000	16,529.33	
Mar. 23, 1938	do	500	50,000	77,640.39	
Mar. 29, 1938	do	300	30,000	40,578.55	

NORFOLK & WESTERN RR. CO.—STOCK (COMMON), INVESTMENT ANALYSIS—Continued

OWNED BY PENNSYLVANIA RR. CO.—Continued

[Par $100 per share]

Date	Acquired by—	Shares	Par value	Book value	
Mar. 31, 1938	do	100	$10,000	$13,526.26	
Apr. 1, 1938	do	100	10,000	13,526.26	
May 31, 1940	do	100	10,000	18,031.00	
Mar. 10, 1942	do	100	10,000	16,529.00	
Mar. 12, 1942	do	100	10,000	16,529.00	
Mar. 13, 1942	do	400	40,000	65,841.00	
Mar. 16, 1942	do	100	10,000	16,354.00	
	Total	382,621	38,262,100	48,565,269.28	
Sept. 8, 1947	Exchanged for $25 par value stock	1,530,484	38,262,100	48,565,269.28	Received 4 shares, $25 par for 1 share $10 par.
Dec. 28, 1954	Cash (P.RR. Co.)	2,858	71,450	53,816.00	
	Total	1,533,342	38,333,550	48,619,085.28	

Date	Acquired	Shares	Par value	Book value	Subject to exchange rights [1] Book value	Subject to exchange rights [1] Shares
December 21, 1959	Cash (P.RR. Co.)	214,954	$5,373,850	$23,000,078		
1960	do	369,491	9,237,275	35,496,073		
1961	do	48,526	1,213,150	5,000,001		
1962	do	162,438	4,060,950	15,387,855		
1963	do	51,345	1,283,625	6,000,083		
1963	Sold (outside)	CR. 37,312	CR. 932,800	CR. 2,092,886		
1966 [1]	Exchange agreement with N. & W. Ry	CR. 800,000		CR. 44,873,600	$104,000,000	800,000
1966	Exchange for N. & W. debs		CR. 2,000,000		CR. 10,400,000	C.R. 80,000
1967	2 exchanges for N. & W. debs		CR. 4,000,000		CR. 20,800,000	CR. 160,000
January 1968	Exchange for N. & W. debs		CR. 2,000,000		CR. 10,400,000	CR. 80,000
February 1968	Exchanged for Pennsylvania Co. 4⅝ percent preferred stock	C.R. 52	C.R. 1,300	CR. 2,917		
December 1968	Cash (outside)	CR. 135,000	CR. 3,375,000	CR. 7,572,420		
June 1969	Exchange for N. & W. debs		CR. 2,000,000		CR. 10,400,000	CR. 80,000
1969	Exchanged for Pennsylvania Co. 4⅝ percent preferred stock	CR. 28	CR. 700	CR. 1,570		
1969	Cash (outside)	CR. 215,799	CR. 5,394,975	CR. 12,104,598		
March 1970	Exchanged for Wabash RR. Common	671,692	16,792,300	54,281,110		
June 1970	Exchanged for N. & W. debs		CR. 2,000,000		CR. 10,400,000	CR. 80,000
1970	Exchanged for Pennsylvania Co. 4⅝ percent prefered stock and 9 percent sinking fund deb	CR. 392,929	CR. 9,823,225	CR. 25,540,778		
1970	Provision for impairment				CR. 8,320,000	
December 1970	Balances	1,470,668	44,766,700	95,595,516	33,280,000	320,000

[1] Under an April 1966 agreement with Norfolk & Western R.R Co. 800,000 shares of its common stock are to be exchanged in stipulated installments to June 1974 for $104,000,000 principal amount of Norfolk & Western 4⅝ percent debentures, convertible into Norfolk & Western common stock by any holder other than Penn Central or its affiliates.

EXHIBIT 46

Norfolk & Western Railway Company - Common Stock

Investment Analysis

Sales of Common Stock in 1963, 1968 and 1969

Trade Date	Sold To	Shares	Book Value	Net Proceeds
3/14/69	Hay, Fales & Co., Inc.	26,440		$ 2,551,392
3/21/69	Salomon Bros. & Hutzler	22,000		2,134,122
3/26/69	"	3,000		291,731
March, 1969		51,440	$ 2,885,372	4,977,245
6/10/69	Salomon Bros. & Hutzler	1,599		150,537
6/16/69	"	500		46,170
6/17/69	"	200		18,468
6/23/69	"	21,700		1,932,610
6/27/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	22,000		1,961,770
June, 1969		45,999	2,580,176	4,109,555
7/10/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	1,400		126,729
7/11/69	"	500		45,234
7/14/69	"	1,500		136,450
7/15/69	"	200		18,193
7/16/69	"	300		27,290
7/18/69	"	1,000		90,467
7/23/69	"	300		27,215
7/24/69	"	700		63,976
7/25/69	"	1,000		89,718
July, 1969		6,900	387,035	625,272
8/ 1/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	2,400		210,837
8/11/69	"	1,000		88,482
8/12/69	Hay, Fales & Co., Inc.	26,000		2,274,464
8/20/69	"	10,000		882,239
8/22/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	460		40,667
8/25/69	"	100		8,897
8/26/69	"	600		52,956
8/27/69	"	600		53,081
8/29/69	Hay, Fales & Co., Inc.	3,000		265,416
8/29/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	200		17,694
August, 1969		44,360	2,488,241	3,894,733

Norfolk & Western Railway Company - Common Stock

Investment Analysis

Sales of Common Stock in 1963, 1968 and 1969

Trade Date	Sold To	Shares	Book Value	Net Proceeds
9/ 2/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	1,000		$ 88,557
9/ 3/69	"	500		44,259
9/ 5/69	Hay, Fales & Co., Inc.	17,000		1,478,725
9/12/69	"	6,000		521,874
9/17/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	800		71,774
9/19/69	"	1,600		143,549
9/22/69	"	3,000		266,910
9/23/69	"	2,300		205,416
9/24/69	"	10,700		950,579
September, 1969		42,900	$ 2,406,347	3,771,643
10/16/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	500		44,297
10/17/69	"	1,500		132,706
10/29/69	"	400		35,288
October, 1969		2,400	134,621	212,291
11/ 3/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	2,200		191,896
11/ 5/69	"	1,000		87,470
11/ 7/69	"	1,000		87,970
11/18/69	"	1,000		83,974
11/19/69	"	1,000		83,724
11/20/69	"	400		33,489
11/25/69	"	200		16,108
11/28/69	"	200		15,896
November, 1969		7,000	392,644	600,527
12/ 5/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	1,000		77,605
12/ 8/69	"	100		7,698
12/ 9/69	"	1,500		113,934
12/12/69	"	800		61,185
12/17/69	"	200		15,295

Norfolk & Western Railway Company - Common Stock

Investment Analysis

Sales of Common Stock in 1963, 1968 and 1969

Trade Date	Sold To	Shares	Book Value	Net Proceeds
12/18/69	Merrill Lynch, Pierce, Fenner & Smith, Inc.	9,200		$ 686,875
12/19/69	"	1,400		106,397
12/24/69	"	600		44,990
December, 1969		14,800	$ 830,162	1,113,980
YEAR, 1969		215,799	$ 12,104,598	$ 19,305,246
12/19/68	Hay, Fales & Co., Inc.	100		$ 10,608
"	"	134,900		13,821,171
YEAR, 1968		135,000	$ 7,572,420	$ 13,831,779
7/ 5/63	First Boston Corporation	37,312	$ 2,092,886	$ 4,506,792

TABLE VI

Commissions and other fees paid in connection with

acquisition of stock during period January 1, 1960 to June 20, 1970

Company Making Acquisition	Company Acquired	To Whom Paid	Date	Amount
Section A (Note 1):				
Buckeye Pipe Line Co.	Pennsylvania R.R. (Penn Central Co.)		8/1964	$ -
Merchants Despatch Transportation Corp.	Baltimore & Ohio R.R. Co.		1/1961-2/1961	(Note 2)
New York Central R.R. Co. (PCTC)	Baltimore & Ohio R.R. Co.		6/1960-3/1963	(Note 2)
			4/1963	(Note 2)
			5/1963	(Note 2)
		Goldman Sachs	6/1963	1,449
		Goldman Sachs	7/1963	2,319
		Goldman Sachs	8/1963	1,636
		Goldman Sachs	9/1963	150
		Bache & Co.	9/1963	1,798
		Goldman Sachs	10/1963	1,075
		Goldman Sachs	11/1963	367
		Bache & Co.	11/1963	1,316
		Bache & Co.	12/1963	550
		Goldman Sachs	1/1964	[illegible]
				[illegible]
New York Central R.R. Co. (PCTC)	Boston & Albany R.R. Co.	Bache & Co.	4/1960	11
		Bache & Co.	5/1960	118
		Bache & Co.	6/1960	215
		Bache & Co.	7/1960	197
		Bache & Co.	8/1960	131
		Bache & Co.	9/1960	77
		Bache & Co.	10/1960	120
		Bache & Co.	11/1960	75

TABLE VI

Commissions and other fees paid in connection with

acquisition of stock during period January 1, 1960 to June 20, 1970

Company Making Acquisition	Company Acquired	To Whom Paid	Date	Amount
Section A (Note 1): cont'd.				
New York Central R.R. Co. (PCTC) continued	Boston & Albany R.R. Co.	Bache & Co.	12/1960	$ 206
		Bache & Co.	1/1961	277
		Adams & Peck	1/1961	53
		Bache & Co.	2/1961	43
		Bache & Co.	3/1961	295
		Bache & Co.	4/1961	301
				2,141
New York Central R.R. Co. (PCTC)	Canada Southern Rwy. Co.		4/1964-5/1966	(Note 2)
		Adams & Peck	6/1966	134
		Adams & Peck	7/1966	372
		L. W. Hoefinghoff & Co.	7/1966	44
		Adams & Peck	8/1966	256
		Adams & Peck	9/1966	87
		Adams & Peck	10/1966	168
		Adams & Peck	11/1966	120
		Adams & Peck	12/1966	233
		Adams & Peck	1/1967	155
		Adams & Peck	2/1967	201
		Adams & Peck	3/1967	194
			4/1967-10/1967	(Note 2)
				1,986
New York Central R.R. Co. (PCTC)	Indiana Harbor Belt R.R. Co.		1/1961	-
New York Central R.R. Co. (PCTC)	Peoria & Eastern Ry. Co.	Adams & Peck	1/1964	37
		Fahnstock & Co.	2/1964	155
			3/1964	-
			7/1964	-

TABLE VI

Commissions and other fees paid in connection with

acquisition of stock during period January 1, 1960 to June 20, 1970

Company Making Acquisition	Company Acquired	To Whom Paid	Date	Amount
Section A-continued (Note 1):				
New York Central R.R. Co. (PCTC) continued	Peoria & Eastern Ry. Co.		12/1965-10/1966	(Note 2)
			11/1966	(Note 2)
			1/1967	(Note 2)
			4/1967	$ -
			5/1967	-
		Bache & Co.	10/1968	273
		Walston & Co., Inc.	5/1969	17
				[illegible]
New York Central R.R. Co. (PCTC)	Pittsburgh & Lake Erie R.R. Co.		6/1965-1/1969	(Note 2)
Northern Refrigerator Line (MDT)	Baltimore & Ohio R.R. Co.		1/1961-2/1961	(Note 2)
Penn Central Co. (PCTC)	Fairport, Painesville & Eastern Rwy. Co.		8/1968	-
Penn Central Co. (Holding Company)	Penn Central Transportation Co.		10/1969	-
Penn Central Co. (PCTC)	New York, New Haven & Hartford R.R. Properties		12/1968	-
Pennsylvania R.R. Co. (PCTC)	Lehigh Valley R.R. Co.		6/1962-2/1965	(Note 2)
Pennsylvania R.R. Co. (PCTC)	Richmond, Fredericksburg & Potomac R.R. Co.		12/1966-6/1968	-
Pennsylvania Co.	Norfolk & Western Rwy. Co.		3/1970	-

TABLE VI

Commissions and other fees paid in connection with

acquisition of stock during period January 1, 1960 to June 20, 1970

Company Making Acquisition	Company Acquired	To Whom Paid	Date	Amount
Section A-continued (Note 1):				
Pennsylvania Co.	Toledo, Peoria & Western R.R. Co.	Edwin A. Lucas, Atty.	7/1959	$ 7,500
		Edwin A. Lucas, Atty.	4/1960	25,000
		Boyd, Walker & Concannon, Attys.	4/1960	3,340
		Morris, James, Hitchens & Williams	4/1960	7,302
		Edwin A. Lucas, Atty.	3/1961	25,000
				68,142
Section B (Note 1):				
Manor Real Estate Co.	Long Island Pipe Line Corp.		2/1964	(Note 2)
Penn Central Co. (Holding Company)	Penn Central International N.V.		2/1970-4/1970	-
Penn Central Company (PCTC)	Terminal Realty Penn Co.		9/1968	-
Section C (Note 1):				
American Contract Co.	Executive Jet Aviation		1965-1967	-
Pennsylvania R.R. Co. (PCTC)	Arvida Corp.		7/1965	-
Pennsylvania Co.	Arvida Corp.		8/1965-3/1966	(Note 2)
		Carl M. Loeb Rhoads & Co.	4/1966	16,000
			6/1966-8/1966	(Note 2)
		Glore Forgan, W.R. Staats, Inc.	9/1966	9,321
		Cyrus J. Lawrence & Sons	10/1966	2,600
			12/1966	(Note 2)
				27,921

TABLE VI

Commissions and other fees paid in connection with acquisition of stock during period January 1, 1960 to June 20, 1970

Company Making Acquisition	Company Acquired	To Whom Paid	Date	Amount
Section C-continued (Note 1):				
Delbay Corp.	Buckeye Pipe Line Co.	Glore Forgan, W.R. Staats,Inc.	1/1963	$ 34,798
		Glore Forgan, W.R. Staats,Inc.	2/1963	404
		Glore Forgan, W.R. Staats,Inc.	3/1963	3,187
		Glore Forgan, W.R. Staats,Inc.	4/1963	1,227
		Glore Forgan, W.R. Staats,Inc.	5/1963	2,341
		Glore Forgan, W.R. Staats,Inc.	6/1963	3,064
		Glore Forgan, W.R. Staats,Inc.	7/1963	1,173
				47,154
Pennsylvania Co.	Buckeye Pipe Line Co.	Dominick & Dominick	11/1963	2,355
		Glore Forgan, W.R. Staats,Inc.	11/1963	50,235
		Dominick & Dominick	12/1963	1,393
		Glore Forgan, W.R. Staats,Inc.	12/1963	17,574
		Goldman Sachs & Co.	12/1963	12,613
		Brown Brothers, Harriman & Co.	12/1963	38,809
		The First Boston Corp.	12/1963	1,625
		Covington & Burling	7/1964	4,300
		Berl, Potter & Anderson	8/1964	2,500
		Glore Forgan, W.R. Staats,Inc.	8/1964	200,000
				331,394
Pennsylvania Co.	Great Southwest Corp.	Glore Forgan, W.R. Staats,Inc.	7/1964	259,153
		Glore Forgan, W.R. Staats,Inc.	8/1964	1,357
		Carrington, Johnson & Stevens	8/1964	700
			9/1964-12/1964	(Note 2)
		Carrington, Johnson & Stevens	1/1965	3,700
		Merrill Lynch, Pierce, Fenner & Smith, Inc.	1/1965	2,462
			2/1965-4/1965	(Note 2)
		Carrington, Johnson & Stevens	5/1965	925
			6/1965-7/1965	(Note 2)
		Glore Forgan, W.R. Staats,Inc.	8/1965	1,373

TABLE VI

Commissions and other fees paid in connection with

acquisition of stock during period January 1, 1960 to June 20, 1970

Company Making Acquisition	Company Acquired	To Whom Paid	Date	Amount
Section C-continued (Note 1):				
Pennsylvania Co. continued	Great Southwest Corp.		9/1965	(Note 2)
		Glore Forgan, W.R. Staats, Inc.	10/1965	$ 1,[illegible]
		Merrill Lynch, Pierce, Fenner & Smith, Inc.	10/1965	3,420
			12/1965-12/1969	(Note 2)
				27[illegible],357
Pennsylvania R.R. Co. (PCTC)	Great Southwest Corp.		2/1962-3/1965	-
Pennsylvania Co.	Penn Towers, Inc.		12/1963	-
Pennsylvania R.R. Co. (PCTC)	Penn Towers, Inc.		4/1961	-
Macco Development Corp.	Macco Realty Co.	To various brokers under tender offer through Bank of American National Trust and Savings Assoc.	10/1965	455,211
		Glore Forgan, W.R. Staats, Inc.	11/1965	453
		Glore Forgan, W.R. Staats, Inc.	12/1965	210
		Kindel & Anderson - legal fees	12/1965	100,765
		Glore Forgan, W.R. Staats, Inc.	1/1966	595
		Glore Forgan, W.R. Staats, Inc.	2/1966	54
		Glore Forgan, W.R. Staats, Inc.	3/1966	[illegible]
		Glore Forgan, W.R. Staats, Inc.	4/1966	27
		Glore Forgan, W.R. Staats, Inc.	7/1966	24
		Great Southwest Corp. acquisition costs	7/1966	[illegible]

TABLE VI

Commissions and other fees paid in connection with

acquisition of stock during period January 1, 1960 to June 20, 1970

Company Making Acquisition	Company Acquired	To Whom Paid	Date	Amount
Section C-continued (Note 1):				
New York Central R.R. (NYC)	Strick Companies		11/1966-1968	$ -
Penn Central Transportation Co.	Madison Square Garden Corp.		12/1968-1969	-
Penn Central Co. (Holding Company)	Southwestern Oil & Refining Co. and Royal Petroleum Corp.		2/1970	(Note 2)

NOTES

1. The above Table reflects stock acquisitions from the following Tables:

   Section A from "Table I"
   Section B from "Table II"
   Section C from "Acquisitions - Selected Subsidiaries"

2. This Table will be up-dated for any fees or commissions when files for these acquisitions are located and examined.

Penn Central Transportation Co.

DIVIDENDS AND INTEREST FROM SUBSIDIARIES—PERIOD 1964 THRU 1969

PENN CENTRAL TRANSPORTATION CO. DIVIDENDS FROM SUBSIDIARIES, YEARS 1964–69

[In millions of dollars]

	1969	1968	1967	1966	1965	1964	Total
RAILROAD RELATED							
American Contract Co	3.3	1.5	3.1	0.3	0.3	1.0	9.5
Clearfield Bituminous Coal Corp	.7	.8	.7	.6	.6	.3	3.7
Despatch Shops, Inc	1.0						1.0
Mahoning Coal Railroad Co	1.7	1.7	1.7	1.6	1.5	1.2	9.4
Manor Real Estate Co	2.0						2.0
Merchants Despatch Transportation Corp	4.7	2.4	.8		.6	.6	9.1
New York Central Transport Co	14.5	1.0					15.5
Pittsburgh & Lake Erie Railroad Co	4.6	4.3	4.0	4.0	3.9	3.1	23.9
Toronto, Hamilton & Buffalo Railway Co	.3	.3	.8	1.2	1.5	1.7	5.8
Other	1.6	1.4	1.3	3.2	1.6	1.7	10.8
Total	34.4	13.4	12.4	10.9	10.0	9.6	90.7
INVESTMENT RELATED							
Pennsylvania Co	24.0	24.0	25.5	24.0	23.0	20.0	140.5
Strick Holding Co	4.8						4.8
Total	28.8	24.0	25.5	24.0	23.0	20.0	145.3
Grand total	63.2	37.4	37.9	34.9	33.0	29.6	236.0

SELECTED SUBSIDIARIES, PENNSYLVANIA CO.

CASH DIVIDENDS AND INTEREST, YEARS 1964–69

	Dividends	Interest
Received from		
Buckeye	$33,515,000	
Macco		$2,458,592
GSC	4,266,441	460,333
Strick		1,223,241
EJA		624,046
Total	37,781,441	4,766,212

Detroit, Toledo & Ironton RR	D.T.I. Enterprises, Inc	July 1965	$1,140,000
		February 1969	360,000
		October 1969	225,000
		August 1970	75,000
Montour RR. Co	Montour Land Co	December 1962	160,000
		December 1963	100,000
		December 1964	75,000
		December 1967	75,000
Penn Central Transportation Co	American Contract Co	December 1960	100,000
		December 1961	150,000
		December 1962	500,000
		December 1963	100,000
		December 1964	500,000
		February 1965	500,000
		December 1965	300,000
		December 1966	250,000
		January 1967	2,750,000
		December 1967	350,000
		February 1968	1,450,000
		July 1969	[2] 326,100
		do	3,000,000
Do	Chicago & Harrisburg Coal	November 1961	30,000
		November 1963	50,000
		February 1966	125,000
		February 1967	125,000
		February 1968	125,000
		March 1969	125,000
		April 1970	125,000
Do	Clearfield Bituminous Coal Corp	July 1960	250,000
		July 1961	250,000
		November 1961	250,000
		January 1964	300,000
		January 1965	600,000
		February 1966	600,000
		February 1967	700,000
		February 1968	700,000
		August 1968	100,000
		March 1969	700,000
Do	Cleveland Technical Center	December 1962	15,000
		December 1963	20,000
		December 1964	50,000
		December 1965	60,000
		December 1966	60,000
		January 1968	50,000
		March 1969	40,000

TABLE V.—DIVIDENDS PAID BY NDNRAIL SUBSIDIARIES TD PENN CENTRAL TRANSPDRTATIDN CD., ITS RAIL SUBSIDIARIES AND PENNSYLVANIA CD.—PERIDD: JAN. 1, 1960 TD JUNE 20, 1970

Company receiving dividend	Company making payment	Date	Amount [1]
Do	Despatch Shops, Inc	May 1960	$825,000
		July 1960	825,000
		July 1961	825,000
		November 1961	800,000
		February 1962	825,000
		July 1962	800,000
		July 1969	1,000,000
Do	Great Southwest Corp	July 1968	4,050
		August 1968	27,084
		November 1968	8,125
		January 1969	4,050
		February 1969	8,125
		May 1969	8,125
		August 1969	8,125
Do	do	September 1969	4,650
		November 1969	8,125
		December 1969	4,050
		February 1970	8,125
		May 1970	8,125
Do	Manor Real Estate Co	November 1969	2,000,000
Do	Merchants Trucking Co	December 1969	50,000
Do	New York Central Transport Co	October 1968	1,000,000
		April 1969	6,000,000
		July 1969	6,000,000
		December 1969	2,500,000
Do	Pennsylvania Truck Lines, Inc	December 1960	320,076
		December 1961	371,992
		December 1962	466,973
		December 1963	268,230
		December 1964	268,230
		December 1965	268,230
		December 1966	450,000
		December 1967	190,461
		December 1968	82,449
		December 1969	52,205
Do	Penntruck Co	do	100,000
Do	Strick Holding Co	November 1969	4,812,708
Pennsylvania Co	Buckeye Pipe Line Co	September 1964	350,000
		December 1964	2,500,000
		March 1965	1,430,000
		June 1965	1,200,000
		September 1965	1,500,000
		December 1965	1,835,000
Do	do	September 1966	1,600,000
		June 1966	1,300,000
		September 1966	1,600,000
		December 1966	1,300,000
		March 1967	1,800,000
		June 1967	1,300,000
		September 1967	1,700,000
		December 1967	1,500,000
		March 1968	1,800,000
		June 1968	1,300,000
		September 1968	1,600,000
		December 1968	1,600,000
		March 1969	1,800,000
		June 1969	1,300,000
		September 1969	1,600,000
		December 1969	1,600,000
		March 1970	1,800,000
		June 1970	1,300,000
Do	Great Southwest Corp	July 1967	219,781
		June 1968	420,926
		July 1968	210,000
		December 1968	425,663
		July 1969	302,722
		August 1969	452,625
		September 1969	1,117,362
		December 1969	1,117,362

[1] Amount represents the carrying value of the investment in the capital stock of Merchants Trucking Co. and Penntruck Co. on the books of American Contract Co. Both investments wree distributed as a dividend to Penn Central Transportation Co.

[2] All dividends, with the exception of dividends of $326,100 (see note 1) were received in cash.

PENNSYLVANIA CO. DIVIDEND INCOME

	1965 Rate	1965 Amount	1966 Rate	1966 Amount	1967 Rate	1967 Amount
Buckeye Pipe Line Co.		$5,965,000		$5,555,000		$5,600,000
Detroit, Toledo & Ironton R.R. Co.	$15.45	3,527,425	$12.40	3,042,080		
Great Southwest Corp. Preferred			6 [1]	67,500	6 [1]	210,000
Macco Realty Co. Perferred			6 [1]	1,040,480	6 [1]	2,362,242
Norfolk & Western Ry. Co. Common (1)	6.50	15,228,096	6.50	15,068,096	6.50	14,428,096
Toledo, Peoria & Western R.R. Co.	5.00	225,000	5.00	225,000	5.00	225,000
Wabash R.R. Co. common (2)	22.84	13,595,181	19.25	11,458,659	15.30	9,107,402
Other (3)		4,893,684		4,608,368		4,593,915
Total		43,434,386		41,085,183		36,526,655
(1) Interest—N. & W. debentures				120,250		761,577
(2) Includes special dividends account:						
D.T. & I. stock	7.94	4,725,881				
Ann Arbor stock	1.25	744,069	3.75	2,232,206		
(3) Principally Leased Line stocks and Wabash preferred.						

[1] Percent.

Financial Department, Sept. 15, 1966.

PENNSYLVANIA CO.—DIVIDENDS RECEIVED FROM BUCKEYE PIPE LINE CO. AND GREAT SOUTHWEST CORP., JAN. 1, 1964, TO DEC. 31, 1970

Year	Buckeye Pipe Line Co.	G-eat Southwest Corp.
1964	$2,850,000	
1965	5,965,000	
1966	5,800,000	
1967	6,300,000	$219,781
1968	6,300,000	1,056,589
1969	6,300,000	2,990,071
1970	3,100,000	
Totals	36,615,000	4,266,441

PENNSYLVANIA CO. AND PENN CENTRAL TRANSPORTATION CO.

SUMMARY OF INTEREST RECEIVABLE FROM SELECTED SUBSIDIARIES—JAN. 1, 1964 TO DEC. 31, 1969

[Dollars in thousands except per share data]

Year	Pennsylvania Co.			Penn Central Transportation Co.
	Macco Realty Co.	Great Southwest Corp.	Executive Jet Aviation, Inc.	Strick Holding Co.
1969	$1,297	$195		
1968	571	200		$690
1967	104	57	$136	533
1966	310	8	370	
1965	495		118	
1964				
Total accrued interest	2,777	460	624	1,223
1969-65 less cash received	2,055	24	624	1,223
1969 balance exchanged for common stock of Great Southwest Corp., at $18 per share	722	436		

TABLES III-IV.—QUARTERLY BALANCES FOR THE PERIOD JAN. 1, 1960, TO JUNE 20, 1970, OF PENN CENTRAL TRANSPORTATION CO.'S, LOANS AND ADVANCES RECEIVABLE FROM (PAYABLE TO) NONRAIL SUBSIDIES [1 2]

[In thousands]

Nonrail subsidies	1960				1961				1962			
	March 31	June 30	September 30	December 31	March 31	June 30	September 30	December 31	March 31	June 30	September 30	December 31
American Contract Co	$22,450	$22,437	$22,417	$22,410	$22,395	$22,392	$22,389	$22,381	$22,373	$22,389	$22,394	$22,362
Buckeye Pipe Line Co												
Cambria Land Co												
Chicago & Harrisburg Coal Co												
Clearfield Bituminous Coal Corp								2,500	2,300	2,100	1,920	1,520
Delbay Corp												
Despatch Shops, Inc				116								
Excelsior Truck Leasing Co., Inc												
Exotic Enterprises, Inc	40	34	34	34	29	29	29	29	29	24	24	24
51st Street Realty Corp												
Jersey City Stock Yards [4c]	605	640	640	675	695	725	725	([4c])				
Manor Real Estate Co	22,275	22,731	24,272	23,656	23,043	22,970	23,215	21,416	22,341	21,436	21,198	21,163
New England Car Co. [5]												
New England Transportation Co. [5]												
New York Central Development Corp	1,465	1,445	1,445	1,254	1,254	1,254	1,262	1,262	1,237	1,237	1,191	1,091
New York Central Transport Co	1,332	1,332	1,332	1,332	1,332	1,332	1,382	1,382	1,607	1,607	1,607	1,882
New York State Realty and Term. Co	16,118	16,102	16,086	15,245	15,114	15,099	15,094	14,559	13,943	13,815	13,315	12,501
Penn Central Co. [3]												
Penn Central Park, Inc												
Penndiana Improvement Corp	2,794	2,785	2,847	2,818	2,818	2,818	2,818	2,818	2,808	2,808	2,808	2,758
Penn Plaza Venture												
Pennsylvania Truck Lines, Inc												
Penn Terminal Real Estate Corp												
Penn Towers, Inc												
Providence Produce Warehouse Co. [5]												
Realty Hotels, Inc												
Strick Holding Co												
Terminal Realty Penn Co												
Western Warehousing Co	4,738	4,738	4,738	4.738	4,738	4,738	4,738	4,738	4,738	4,738	4,738	4,813

Nonrail subsidies	1963				1964				1965			
	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
American Contract Co	$22,862	$22,862	$22,862	$19,888	$19,888	$19,826	$19,826	$16,126	$20,576	$22,716	$24,196	$24,133
Buckeye Pipe Line Co												
Cambria Land Co												
Chicago & Harrisburg Coal Co												
Clearfield Bituminous Coal Corp	1,220	420	300									
Delbay Corp												
Despatch Shops, Inc	10,745	10,745	10,743	10,527	10,526	9,011	7,511	6,799	6,480	6,279	6,270	5,764
Excelsior Truck Leasing Co., Inc				140								
Exotic Enterprises, Inc. [4b]	24	([4b])										
51st Street Realty Corp												
Jersey City Stock Yards [4c]												

Manor Real Estate Co.	21,979	25,704	27,295	30,937	31,674	32,610	34,046	34,068	33,332	33,331	34,119	34,271
New England Car Co.[5]												
New England Transportation Co.[5]												
New York Central Development Corp.	1,091	1,091	1,080	1,095	1,095	1,095	1,045	945	945	945	905	845
New York Central Transport Co.	1,882	2,020	2,020	2,020	2,020	2,020	2,020	2,020	2,020	20,020	2,020	2,020
New York State Realty and Term. Co.	([4e])											
Penn Central Co.[3]												
Penn Central Park, Inc.												
Penndiana Improvement Corp.	2,758	2,758	2,852	2,820	2,820	2,820	2,820	2,820	2,810	2,967	2,746	2,746
Penn Plaza Venture											3,300	3,300
Pennsylvania Truck Lines, Inc.												
Penn Terminal Real Estate Corp.											348	1,137
Penn Towers, Inc.												
Providence Produce Warehouse Co.[5]												
Realty Hotels, Inc.						165	165	165	165	165	165	165
Strick Holding Co.												
Terminal Realty Penn Co.												
Western Warehousing Co.	4,913	4,913	4,193	4,963	5,038	5,038	5,038	5,038	5,188	1,588	5,188	5,188

	1966				1967				1968			
	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
American Contract Co.	($7,991)	($5,741)	($5,194)	($5,109)	($4,248)	($3,543)	($19,413)	($19,413)	($19,413)	($19,413)	($19,413)	($19,413)
Buckeye Pipe Line Co.							(9,000)	(2,500)	(1,700)	(400)		
Cambria Land Co.												
Chicago & Harrisburg Coal Co.												
Clearfield Bituminous Coal Corp.												(1,043)
Delbay Corp.	542	542	542	542	542	542	542	542	542	542	542	542
Despatch Shops, Inc.	5,763	5,763	5,762	4,778	2,663	2,532	2,506	863	1,374	1,976	2,024	1,575
Excelsior Truck Leasing Co., Inc.												1,720
Exotic Enterprises, Inc.[4b]												
51st Street Realty Corp.												
Jersey City Stock Yards[4c]												
Manor Real Estate Co.	33,578	35,574	38,301	36,860	38,876	44,112	37,673	37,522	37,913	39,770	41,640	37,043
New England Car Co.[5]											([5])	16
New England Transportation Co.[5]											([5])	434
New York Central Development Corp.	845	835	840	610	635	635	635	660	560	730	1,430	1,630
New York Central Transport Co.	2,020	2,020	2,020	2,020	2,020	2,020	2,020	2,020	2,020	2,020	2,020	2,020
New York State Realty & Term. Co.[4e]												
Penn Central Co.[3]												
Penn Central Park, Inc.					265	265	265	714	1,345	1,780	2,099	2,099
Penndiana Improvement Corp.	2,745	2,745	2,745	2,745	2,745	2,745	1,680	1,680	1,680	1,680	1,680	1,680
Penn Plaza Venture[4f]	3,300	3,300	3,300	3,900	4,100	3,300	1,200	1,400	1,617	1,832	2,042	([4f])
Pennsylvania Truck Lines, Inc.												
Penn Terminal Real Estate Corp.[4f]	1,205	1,760	20	13	2	132	154	344	886	1,707	1,994	([4f])
Penn Towers, Inc.	239	684	764	764	858	1,153	1,208	1,208	1,158	1,313	1,353	1,353
Providence Produce Warehouse Co.[5]											([5])	4,136
Realty Hotels, Inc.	165	165	165	165	165	565	565	565	565	565	565	730
Strick Holding Co.				2,997	6,997	8,997	9,437	9,437	9,437	9,437	9,437	(19,700)
Terminal Realty Penn Co.												
Western Warehousing Co.	5,288	5,288	5,338	5,338	5,510	5,510	5,555	5,480	5,719	5,719	5,719	5,719

TABLES III-IV.—QUARTERLY BALANCES FOR THE PERIOD JAN. 1, 1960, TO JUNE 20, 1970, OF PENN CENTRAL TRANSPORTATION CO.'S, LOANS AND ADVANCES RECEIVABLE FROM (PAYABLE TO) NONRAIL SUBSIDIES [1] [2]—Continued

[In thousands]

	1969				1970	
	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 20
American Contract Co	($19,413)	($21,413)	($18,413)	($17,380)	($17,315)	($17,315)
Buckeye Pipe Line Co	(3,500)					
Cambria Land Co ([4a])	(260)	(260)	([4a])			
Chicago & Harrisburg Coal Co			(200)	(200)	(250)	(175)
Clearfield Bituminous Coal Corp	(6,452)	(1,802)	(2,827)	(3,527)	(5,129)	(5,129)
Delbay Corp	487	824	839			
Despatch Shops, Inc	1,527	815	(1,045)	2,387	(1,112)	(1,216)
Excelsior Truck Leasing Co., Inc	1,518	1,417	2,115	2,445	213	(150)
Exotic Enterprises, Inc. [4b]						
51st Street Realty Corp		(150)	(175)	(125)	(75)	
Jersey City Stock Yards [4c]						
Manor Real Estate Co	20,804	28,910	21,557	24,022	24,106	25,381
New England Car Co. [4d] [5]	16	16	16	16	([4d])	
New England Transportation Co.[5]	434	434	434	434	434	434
New York Central Development Corp	1,630	1,630	1,630	1,880	2,030	1,780
New York Central Transport Co	270	3,020	7,020	6,720	11,070	12,020
New York State Realty & Term. Co. [4e]						
Penn Central Co.[3]			([3])	340	7,722	13,335
Penn Central Park, Inc	2,400	2,425	2,515	2,540	3,861	5,493
Penndiana Improvement Corp	1,680	1,680	1,680	1,680	2,830	2,635
Penn Plaza Venture [4f]						
Pennsylvania Truck Lines, Inc	(300)					
Penn Terminal Real Estate Corp. [4f]						
Penn Towers, Inc	1,363	1,763	1,713	1,753	1,578	1,603
Providence Produce Warehouse Co.[5]	4,136	4,136	4,136	3,985	3,885	3,736
Realty Hotels, Inc	730	730	730	730	730	730
Strick Holding Co. [4g]	(19,700)	(19,684)	(14,084)	([4g])		
Terminal Realty Penn Co				(164)	(212)	(279)
Western Warehousing Co	5,719	5,719	6,020	6,120	6,355	6,380

[1] Loans and advances receivable from (peyable to) nonrail subsidiaries include notes, loans, and advences but do not include bonds or equipment obligations.

[2] Amounts reported by Penn Central Transportation Co. were compered with amounts reported by the nonrail subsidiaries. Differences of $100,000 or more were reconciled and for an insignificant number of differences of less than $100,000, account balances from Penn Central Transportation Co's. records were shown.

[3] All companies listed ere subsidiaries of Penn Central Transportation Co. with the exception of Penn Central Co., the transportation company's parent (Penn Centrel Co. was formed in October 1969).

[4] Subsidiaries merged, dissolved or sold during the reporting period ere as follows:

(a) Cambria Land Co. merged into Manor Real Estate Co. in September 1969.

(b) Exotic Enterprises, Inc. wes dissolved in June 1963.

(c) Jersey City Stock Yards was dissolved in December 1961. Assets and liabilities were transferred to sole stockholder, Pennsylvania Railroad Co. (Penn Central Transportation Co.).

(d) New England Cer Co. wes dissolved in Merch 1970. Assets and liebilities were trensferred to sole stockholder, Providence Produce Werehouse Co.

(e) New York Stete Realty end Terminel Co. merged into Despatch Shops, Inc. in Januery 1963.

(f) Investment in Penn Terminel Real Estete Corp. and Penn Plaza Venture wes exchanged for Common and Preferred Stock of Madison Square Garden in December 1968.

(g) Strick Holding Co. merged into Penn Central Transportation Co. in December 1969.

[5] The properties and investments of the New York, New Heven & Hartford RR. Co. were acquired by Penn Centrel Transportation Co. as of December 31, 1968. Amounts due to the New Haven from its subsidiaries (New England Car Co., New Englend Transportation Co., and Providence Produce Werehouse Co.) reflected in the teble as December 31, 1968, belences were receivable by the New Heven prior to its ecquisition by the transportation company.

TABLES III-IV.—QUARTERLY BALANCES FOR THE PERIOD JAN. 1, 1960, TO JUNE 20, 1970, OF RAIL SUBSIDIARIES LOANS AND ADVANCES RECEIVABLE FROM (PAYABLE TO) NONRAIL SUBSIDIARIES [1]

[In thousands]

Rail subsidiaries	Nonrail subsidiaries	1960 Mar. 31	1960 June 30	1960 Sept. 30	1960 Dec. 31	1961 Mar. 31	1961 June 30	1961 Sept. 30	1961 Dec. 31
Pennsylvania Co	American Contract Co								
Pennsylvania Co	Arvida Corp								
Pennsylvania Co	Buckeye Pipe Line Co								
Pennsylvania Co	Great Southwest Corp								
Pennsylvania Co	Macco Develop nent Corp								
Pennsylvania Co	Macco Realty Co								
Associates of the Jersey Co	Manor Real Estate Co								
Phila., Balto, & Wash. RR. Co	Manor Real Estate Co	$39	$39	$39	$39	$39	$39	$39	$39
Western Allegheny RR. Co	Manor Real Estate Co								
Detroit, Toledo & Ironton RR. Co	DTI Enterprises, Inc	1,566	1,566	1,301	1,301	1,316	1,321	1,338	1,278
American Contract Co	Executive Jet Aviation, Inc								
		1962 Mar. 31	**1962 June 30**	**1962 Sept. 30**	**1962 Dec. 31**	**1963 Mar. 31**	**1963 June 30**	**1963 Sept. 30**	**1963 Dec. 31**
Pennsylvania Co	American Contract Co								
Pennsylvania Co	Arvida Corp								
Pennsylvania Co	Buckeye Pipe Line Co								
Pennsylvania Co	Great Southwest Corp								
Pennsylvania Co	Macco Development Corp								
Pennsylvania Co	Macco Realty Co								
Associates of the Jersey Co	Manor Real Estate Co								
Phila., Balto. & Wash. RR. Co	Manor Real Estate Co	$33	$39	$39	$39	$39	$39	$39	$39
Western Allegheny RR. Co	Manor Real Estate Co								
Detroit, Toledo & Ironton RR. Co	DTI Enterprises, Inc	1,278	1,288	1,290	1,397	1,391	1,590	1,658	1,735
American Contract Co	Executive Jet Aviation, Inc								
		1964 Mar. 31	**1964 June 30**	**1964 Sept. 31**	**1964 Dec. 31**	**1965 Mar. 31**	**1965 June 30**	**1965 Sept. 30**	**1965 Dec. 31**
Pennsylvania Co	American Contract Co								
Pennsylvania Co	Arvida Corp								
Pennsylvania Co	Buckeye Pipe Line Co								
Pennsylvania Co	Great Southwest Corp								
Pennsylvania Co	Macco Development Corp.[2a]							([2a])	$39,235
Pennsylvania Co	Macco Realty Co								
Associates of the Jersey Co	Manor Real Estate Co			($407)	($407)	($814)	($814)	($1,221)	(1,221)
Phila., Balto. & Wash. RR. Co	Manor Real Estate Co	$39	$39	39	39	39	39	39	39
Western Allegheny RR. Co	Manor Real Estate Co								
Detroit, Toledo & Ironton RR. Co	DTI Enterprises, Inc	1,741	1,738	1,794	1,816	2,017	2,289	1,690	1,686
American Contract Co	Executive Jet Aviation, Inc				575	2,893	5,846	8,011	8,163

		1966				1967			
		Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
Pennsylvania Co.	American Contract Co.							$16,255	$15,801
Pennsylvania Co.	Arvida Corp.							(500)	(250)
Pennsylvania Co.	Buckeye Pipe Line Co.								
Pennsylvania Co.	Great Southwest Corp.								3,000
Pennsylvania Co.	Macco Development Corp.[2a]	$39,244	$39,235	([2a])					
Pennsylvania Co.	Macco Realty Co.			$750		($1,300)	$1,350	3,700	6,000
Associates of the Jersey Co.	Manor Real Estate Co.	(1,629)	(1,629)	(2,036)	($2,036)	(2 443)	(2,443)	(2,850)	(2,850)
Phila., Balto. & Wash. RR. Co.	Manor Real Estate Co.	39	39	39	39	39	39	39	39
Western Allegheny RR. Co.	Manor Real Estate Co.								
Detroit, Toledo & Ironton RR. Co.	DTI Enterprises, Inc.	1,671	1,667	1,663	1,679	1,676	1,672	1,698	1,694
American Contract Co.	Executive Jet Aviation, Inc.	9,664	12,050	12,081	13,865	14,861	15,591	15,976	16,306

		1968				1969				1970	
		Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 20
Pennsylvania Co.	American Contract Co.	$15,681	$15,881	$15,916	$18,205	$20,305	$20,305	$20,305	$20,305	$20,305	$20,305
Pennsylvania Co.	Arvida Corp.	(250)	(250)								
Pennsylvania Co.	Buckeye Pipe Line Co.									(5,500)	
Pennsylvania Co.	Great Southwest Corp.	3,000	3,000	3,000	3,000	18,550	20,900	21,600			
Pennsylvania Co.	Macco Development [2a]										
Pennsylvania Co.	Macco Realty Co. [2b]	7,100	9,100	12,100	13,400	([2b])					
Associates of the Jersey Co.	Manor Real Estate Co.	(3,257)	(3,257)	(3,664)	(3,664)	(4,071)	(4,071)	(4.478)	(4,478)	(4,886)	(4,886)
Phila., Balto. & Wash. RR. Co.	Manor Real Estate Co.	39	39	39	39	39	39	39	39	39	39
Western Allegheny RR. Co. [2c]	Manor Real Estate Co.	775	775	775	775	775	775	([2c])			
Detroit, Toledo & Ironton RR. Co.	DTI Enterprises, Inc.	1,691	1,657	1,653	1,649	2,131	2,192	2,188	2,230	2,491	2,488
American Contract Co.	Executive Jet Aviation, Inc.	16,421	16,621	16,621	19,020	21,020	21,020	21,020	21,020	21,020	21,020

[1] Amounts reported also include quarterly balances between American Contract Co. and Executive Jet Aviation, Inc.
[2] Subsidiaries merged during the reporting period are as follows:
[a] Macco Development Corp. was incorporated in August 1965 and in October 1965 Macco Development acquired Macco Realty Co. In July 1966 Macco Realty merged into Macco Development and the name of the company was changed to Macco Realty Co.
[b] Macco Realty Co. merged into Great Southwest Corp. in March 1969.
[c] Western Allegheny RR. Co. merged into Manor Real Estate August 1969.

TABLE V.—DIVIDENDS PAID BY NONRAIL SUBSIDIARIES TO PENN CENTRAL TRANSPORTATION CO., ITS RAIL SUBSIDIARIES AND PENNSYLVANIA CO.—JAN. 1, 1960, TO JUNE 20, 1970

Company receiving dividend	Company making payment	Date	Amount [2]
Detroit, Toledo & Ironton RR	D.T.I. Enterprises, Inc	July 1965	$1,140,000
		February 1969	360,000
		October 1969	225,000
		August 1970	75,000
Montour RR. Co	Montour Land Co	December 1962	160,000
		December 1963	100,000
		December 1964	75,000
		December 1967	75,000
Penn Central Transportation Co	American Contract Co	December 1960	100,000
		December 1961	150,000
		December 1962	500,000
		December 1963	100,000
		December 1964	500,000
		February 1965	500,000
		December 1965	300,000
		December 1966	250,000
		January 1967	2,750,000
		December 1967	350,000
		February 1968	1,450,000
		July 1969	[1] 326,100
		do	3,000,000
Do	Chicago & Harrisburg Coal	November 1961	30,000
		November 1963	50,000
		February 1966	125,000
		February 1967	125,000
		February 1968	125,000
		March 1969	125,000
		April 1970	125,000
Do	Clearfield Bituminous Coal Corp	July 1960	250,000
		July 1961	250,000
		November 1961	250,000
		January 1964	300,000
		January 1965	600,000
		February 1966	600,000
		February 1967	700,000
		February 1968	700,000
		August 1968	100,000
		March 1969	700,000
Do	Cleveland Technical Center	December 1962	15,000
		December 1963	20,000
		December 1964	50,000
		December 1965	60,000
		December 1966	60,000
		January 1968	50,000
		March 1969	40,000
Do	Despatch Shops, Inc	May 1960	825,000
		July 1960	825,000
		July 1961	825,000
		November 1961	800,000
		February 1962	825,000
		July 1962	800,000
		July 1969	1,000,000
Do	Great Southwest Corp	July 1968	4,050
		August 1968	27,084
		November 1968	8,125
		January 1969	4,050
		February 1969	8,125
		May 1969	8,125
		August 1969	8,125
		September 1969	4,650
		November 1969	8,125
		December 1969	4,050
		February 1970	8,125
		May 1970	8,125
Do	Manor Real Estate Co	November 1969	2,000,000
Do	Merchants Trucking Co	December 1969	50,000
Do	New York Central Transport Co	October 1968	1,000,000
		April 1969	6,000,000
		July 1969	6,000,000
		December 1969	2,500,000
Do	Pennsylvania Truck Lines, Inc	December 1960	320,076
		December 1961	371,992
		December 1962	466,973
		December 1963	268,230
		December 1964	268,230
		December 1965	268,230
		December 1966	450,000
		December 1967	190,461
		December 1968	82,449
		December 1969	52,205
Do	Penntruck Co	December 1969	100,000
Do	Strick Holding Co	November 1969	4,812,708

TABLE V.—DIVIDENDS PAID BY NONRAIL SUBSIDIARIES TO PENN CENTRAL TRANSPORTATION CO., ITS RAIL SUBSIDIARIES AND PENNSYLVANIA CO.—JAN. 1, 1960, TO JUNE 20, 1970—Continued

Company receiving dividend	Company making payment	Date	Amount [2]
Pennsylvania Co	Buckeye Pipe Line Co	September 1964	$350,000
		December 1964	2,500,000
		March 1965	1,430,000
		June 1965	1,200,000
		September 1965	1,500,000
		December 1965	1,835,000
		September 1966	1,600,000
		June 1966	1,300,000
		September 1966	1,600,000
		December 1966	1,300,000
		March 1967	1,800,000
		June 1967	1,300,000
		September 1967	1,700,000
		December 1967	1,500,000
		March 1968	1,800,000
		June 1968	1,300,000
		September 1968	1,600,000
		December 1968	1,600,000
		March 1969	1,800,000
		June 1969	1,300,000
		September 1969	1,600,000
		December 1969	1,600,000
		March 1970	1,800,000
		June 1970	1,300,000
Pennsylvania Co	Great Southwest Corp	July 1967	219,781
		June 1968	420,926
		July 1968	210,000
		December 1968	425,663
		July 1969	302,722
		August 1969	452,625
		September 1969	1,117,362
		December 1969	1,117,362

[1] Amount represents the carrying value of the investment in the capital stock of Merchants Trucking Co. and Penntruck Co. on the books of American Contract Co. Both investments were distributed as a dividend to Penn Central Transportation Co.

[2] All dividends, with the exception of dividends of $326,100 (see note 1) were received in cash.

TABLE VII.—INTERCOMPANY SALES OF PROPERTY AND INVESTMENT SECURITIES BETWEEN PENN CENTRAL TRANSPORTATION CO. AND/OR ITS SUBSIDIARIES FOR PERIOD JAN. 1, 1970, TO JUNE 20, 1971[1]

PROPERTIES

By—	To—	Description of property	Use of property	Date of sale	Original purchase date	Original cost	Depreciation recorded	Depreciated L.V.	Sales price	Profit or (loss)
DTI Enterprises	D.T. & I. RR	1.793 acres in private claim 640 city of Allen Park.	Industrial track	May 1970	May 1963	$25,047		$25,047	$25,074	$27
Excelsior Truck Leasing Co	New York Central Transport	Trailers and improvements	For leasing	Jan. 1, 1970	Various	14,977,929	$9,712,642	5,265,287	5,265,287	

INVESTMENT SECURITIES

By—	To—	Description	Date of sale	Number of shares or par value	Book value	Sale price	Profit or (loss)
P.C.T. Co	C.C.C. & St. Louis	C.C.C. & St. Louis Ry. 1st Coll. Tr. (St. Louis Div.) 4 percent Bds. Due Nov. 1, 1990.	Mar. 27, 1970	$82,000	$76,709	$82,000	$5,291
Do	Connecting railway	Connecting Ry. 1st mortgage 3⅛ percent Bds. Ser. "A" due Mar. 1, 1976	Jan. 2, 1970	321,000	249,955	249,955	
Do	Indianapolis Union Ry	Ind. Union. Ry. Ref. and Imp. mortgage 2½ percent series "C" bonds	Mar. 25, 1970	200,000	157,000	157,000	
Do	Pennsylvania Co	Clearfield Bituminous Coal Corp. stock	Mar. 31, 1970	16,500	82,200	16,937,820	16,855,620

[1] Does not include intercompany sales in 1970 which were shown in prior report.

EXHIBIT 47

JUNE 21, 1954.

J. M. S.: An analysis of the proposal to go to complete dieselization would appear to divide itself into two parts—(I) An analysis of the savings to be realized by such a program, and such a review has been made by the Operating Department, and (II) in the event of a decision in the affirmative to go ahead with such a program, the method to be employed in financing such a sizeable amount. The latter also involves the question of timing.

I. REVIEW OF SAVINGS TO BE EFFECTED

(1) It appears that the cost of such a program would be approximately $33,000,000, including additional diesel facilities to be added.

(2) The indicated net savings before taxes is about $7,000,000, or after taxes about $3,250,000, on an annual basis. However, J.P.N. points out "that one savings is to a certain extent theoretical—fuel transportation savings of $1,160,000." Also included in the savings is the elimination of a charge for depreciation on the steam locomotives in the amount of approximately $465,000. This is pure theory, since no cash whatsoever is involved and actually the only reason it is even permitted by the I.C.C. is because it is done on a group basis; and in the long run to the extent that we do continue to charge it on locomotives which have long since been charged off, in the ultimate, an adjustment will have to be made as has been done in the past from time to time because overall depreciation must be kept in line with the composite group of equipment. Finally, we are not clear on the item of steam locomotive repairs which is included in the savings in the amount of $1,400,000. It appears that this represents complete elimination of all steam locomotive repairs, whereas even under this program it is indicated that as reserve power we must keep about 250 steam locomotives, and under I.C.C. regulations specific items of work are required periodically. Perhaps this is exclusive of the $1,400,000, but it is not clear to us.

(3) From the foregoing it is clear that there is an indicated savings within a range, dependent on certain things and based on present levels of traffic. The next question is to what extent these savings can be maintained in the event of a further decline in traffic, and if they can be maintained how much of a cushion is there? It is not as yet at all clear that we have reached a leveling off point in traffic and in business in general, and if any further drop would eliminate these savings, this factor should be seriously evaluated.

(4) It is our understanding that in the past there has been a limit to the number of additional locomotives that can be added at any given time for maximum efficiency and savings to be realized. We assume this still holds true, and the question therefore arises as to what is the maximum rate at which these can be added efficiently.

II. METHOD OF FINANCING

(1) Assuming that the desirability of acquiring these diesels over "X" period of time is decided in the affirmative, the question arises as to the method of financing to be employed. At the outset, to avoid any possible confusion in anyone's mind, leasing is just another method of financing. Other than variations in the accounting treatment and the vesting of title, it is identical with 100% conditional sales financing.

(2) All three methods—equipment trust financing, 100% conditional sales financing, and leasing—involve a principal cash outlay on our part. The only difference between equipment trust financing and the other two methods is that there is an initial down payment. In the case of 100% conditional sales and leasing, this initial down payment must be made up over the initial 15-year period, and in most cases there is an insistence that a high percentage be made up in the first few years. In other words, generally speaking the recovery of the initial down payment is not spread out equally over the 15-year period. Therefore it should be recognized that even in the first year there will be a substantial cash outlay on account of principal in the event of either conditional sales financing or leasing. Over the first five years, in either 100% conditional sales or leasing, generally speaking you will catch up and pay out the initial down payment.

(3) There is no advantage in trying to work the financing through one of the diesel manufacturers. They merely act as a middleman in working out an arrangement with an insurance company or bank, and there is no reason to believe that they can do this any more successfully than can we, and based on past experience there is considerable danger that our credit will be stopped and the waters muddied.

(4) It is estimated that the interest cost of equipment trust financing as against leasing will be approximately ¾ of 1% cheaper, which in the case of an expenditure of $32,000,000. represents an interest differential, in round figures, of $2,000,000.

(5) Looking at the situation from a tax standpoint, there is considerably more flexibility in equipment trust financing than offered by a lease arrangement. Unfortunately, none of us is in a position to predict what tax bracket we are going to be in in each of the next 15 years, and based on past experience it appears that at least in some years our effective tax rate may well be 8.1%. In the case of lease rental, the actual charge cannot be varied depending on variations in your income. In the case of equipment trust financing, however, assuming that we receive accelerated amortization in the amount of 55%, the capital portion can be varied between 3.88% and 12.746%, depending on how much accelerated amortization we keep.

(6) Ideally, we should build up our equipment depreciation to a point where it is sufficient to throw off sufficient cash to meet annual maturities, plus sufficient cash to make down payments on the average amount of equipment financing that we will do each year.

Leasing does not help us move in that direction, which is particularly bad since at the moment, because of accelerated amortization still being charged, we are moving away from our goal looking ahead several years.

(7) With respect to General Motors, we know of no way of carrying out a lease arrangement with them, if we did so desire, except by going through the most unsatisfactory procedure in this case of Anti-Clayton routine.

(8) Creditwise, we are very close to the edge of having the ratings on our securities further reduced, and if this should occur it would add materially to our cost of financing, which could run into millions of dollars. It also would very materially injure the standing of our stock, which is not too good even now, and would in turn tend to put it more and more into the hands of speculators rather than investors; and this was one of the outstanding weaknesses in the position of the New York Central management in the recent proxy battle. It is incumbent on us to guard our credit carefully and one of the essential factors which is helping us at the moment is the confidence on the part of many that we are going to steadily reduce our debt. This year because of the business situation we have had to conserve cash and have been able to do very little in the way of bonded debt retirements, and therefore we are dependent on having a good showing in equipment debt reduction to get the overall required debt reduction. If the business situation clarifies, next year we should be able to do more bonded debt retirements and consequently it will not be necessary for us to show such a substantial reduction in equipment debt.

(9) The demands on us for cash through July 1st in 1955 are very heavy. Next year we have estimated maturities of $52,000,000, of which $45,700,000, as indicated on the attached schedule, comes due by July 1st. In addition, in the first six months of 1955 we will have to pay 100% of our federal income taxes for 1954. Therefore spreading of our capital requirements is desirable.

III. RECOMMENDATIONS

(1) Based on the figures submitted by J.P.N., there appear to be desirable savings involved, subject to the question we have already raised as to how well these can be maintained in the event of a further decline in business. This again brings up the question of timing.

(2) From the standpoint of our program of reducing debt, it would now appear that we should be able, subject to business conditions, to spend about $28,000,000 on equipment next year, which would mean the issuance of $21,000,000 of equipment trust certificates. An orderly marketing program for this amount would involve three or four issues, dependent on market conditions at the time, but tentatively perhaps we could do three, placing them in the months of January, May, and September. We could accelerate the acquisition of the equipment somewhere between 60 and 90 days prior to these dates by the use of temporary leases. Whether or not business will be such, or our other equipment requirements would dictate, that the entire $28,000,000 be spent on diesels, of course is something that will have to be decided. Necessity might well dictate that a portion of this go for freight cars, and with Mr. Young at the New York Central it is quite possible that we may feel called upon to buy some additional passenger equipment, particularly on the New York-Washington run. This is another overall policy matter. Therefore perhaps it might be well also from the standpoint of ability to assimilate this number of diesels, to spread the program over the years 1955 and 1956, but this can be discussed further. Under a program such as is proposed, it should mean that we could acquire roughly $9,000,000 to $10,000,000 of locomotives in October and November as a first step in the program, with the financing in January. By that time we would have gotten over the period when we do not know whether or not we are going to have a steel strike, and we do not know what the prospects are going to be for July, when business is in a very uncertain position. By then we may have a very much better idea as to where business in general is going as well.

(3) In H.H.P.'s memorandum we noticed that the savings before taxes on some of the diesel acquisitions were as low as 4%. I think it would be well to make a very close analysis as to whether or not the acquisition of the entire number of diesels is justified from an economic standpoint ahead of some of the important capital expenditures we still have to make, such as Conway and Holidaysburg. Perhaps something short of complete dieselization would produce proportionately greater savings. On the other hand, which we do not pretend to know, perhaps while the savings on the individual locomotive are small, the overall gain of being completely dieselized would add a certain increment to the savings. We think this should be very carefully weighed.

(4) From an overall standpoint, it also seems to us that we must, where possible, adopt a middle-of-the-road policy on capital expenditures, doing things gradually, because it is apparent from the letters we have already received that the stockholders are highly critical of the fact that we have spent such vast sums of money on the railroad. If we spread a program, it is going to be much less criticized than if we go out and do the whole tremendous amount at one time.

(5) It is recommended that the program as a whole be discussed in general with the Board in June, but that we merely get authority to go ahead with some portion of this program, if it is later deemed advisable, after approval by both the Finance Committee and the Executive Committee. After all, there is a very vital financial question involved and I think that it is highly desirable that all the facts be laid before the Finance Committee in detail before a final decision is made. It could then, if they are satisfied, be confirmed by the Executive Committee.

D. C. B.

Original on temporarary Diesel File No. 0166.

EXHIBIT 48

OCTOBER 22, 1965.

S. T. S.: In view of the fact that it will not be possible for me to be at the Budget Meeting on Monday, I have the following comments to make:

1. CAPITAL BUDGET FOR 1966

At the present time it appears that we will show a net increase in system debt in 1965 of approximately $165 million and on an annual basis an increase in interest charges of almost $8 million. When increased depreciation is taken into consideration, our earnings are not increasing rapidly enough as far as the railroad is concerned to offset the increase in equipment charges. On the basis of the present proposed equipment program for 1966, there will be an additional net increase in system debt next year of about $80 million and a further increase in fixed charges of approximately $4 million. It should also be noted that in our judgment 1966 is going to be a most expensive year for financing and we will find money very scarce and, therefore, financing itself will be difficult to obtain. Coupled with this, we must consider the fact that we are going to have capital expenditures in connection with the merger over and above those now included in the budget and the same applies to capital expenditures in connection with the government experimental high speed passenger program. All in all I believe that the year 1966 is one in which we should attempt to hold down in every way possible our capital expenditures to the extent that we can do so without impairing our service.

With respect to Road Budget, I think there is much to be done. Last year, after the Operating Department had insisted that they had cut expenditures to the bone, it became obvious very quickly that the approved program could not be accomplished during the year.

The $49 million Road program proposed for next year is even higher than the 1965 approved program. I believe it can be cut substantially by a searching review of the economics of each item. For example, although the proposed program includes $12 million for the Penn Station project, there are six additional items included in the Eastern Region figures aggregating an excess of $800,000, for escalators, elevators, lighting modernization of rest rooms, etc. at Penn Station. With the large overrun in this project already recognized and reflected in our estimates, I think we should not add to it by allowing items of this nature to be done outside the confines of the estimated amount of the total project. In addition, from a timing standpoint, this work should be performed as near as possible to the completion of the new station and, therefore, deferred until 1967.

In many cases the savings contemplated are not very attractive. As I understand it, as a result of attending the Central's Budget Meeting, they will not entertain capital expenditures, other than for safety, where the labor savings are less than 20% and if labor only is involved less than 30% after consideration of attrition payments. I think that except for the safety items, our people should be made to go back and figure out the savings involved with particular emphasis on labor. I hope that the total for road this year (exclusive of Penn Station and Corridor expenditures) can be kept between $25 million and $30 million and I believe in all probability that we could limit our capital expenditures for equipment to a maximum of $110 million, particularly if we sincerely believe we are going to be merged in the first half of the year. This would allow for another $25 million over the $85 million which we have previously approved. Also, this is predicated on elimination of $18 million to replace Norfolk and Western cars which I will comment on next.

2. INFORMATION ON EASED NORFOLK AND WESTERN COAL HOPPER CARS

In this analysis there is an indicated saving by replacing the Norfolk and Western cars of approximately $12 million. This is predicated on, among other things, a depreciation of 2.07%. This is purely and simply an historic figure as far as the Pennsylvania Railroad is concerned and is not a true measure of the actual depreciation and is belied by practically every figure used in the formulation of the proposed 5 year program. There is no question that to the extent that we use such a rate, it will be more than offset by an increase in estimated repair expenses. I do not believe there is anyone who sincerely believes that the economic life of these hopper cars is approximately 45 years. As a matter of fact, the depreciation rate charged by the N&W, C&O and Southern is significantly higher than our 2.07%. In view of the foregoing together with the fact that the rate of return to us in requiring our own cars to replace the N&W cars is only about 4% and the increase in our debt and interest charges is already disproportionately large, I think the proposal to return N&W cars and buy our own should be deferred until some future year. Also, I think it would be wise to defer a decision in this matter until we have determined in a more scientific way what our various car requirements should be over the next few years as is discussed next in this memorandum as part of Item #3.

3. THE 5 YEAR EQUIPMENT PROGRAM

First of all, the mere fact that the operating people have attempted to develop an equipment program for a 5 year period in the future is a major step forward. This is something we have advocated for at least 10 years. We believe it is feasible to do this and also essential and necessary to good planning. However, we believe that the program itself has not been soundly conceived and needs a very substantial amount of work done on it. We also are strongly of the opinion that there is a more scientific approach to the whole

problem. There are major discrepancies in the program. As mentioned in arriving at savings with respect to replacement of Norfolk and Western cars, a depreciation rate of 2.07% was used. As contrasted to this, if we figure on a fleet of approximately 120,000 cars, a 5% depreciation rate would mean the annual replacement of only 6,000 cars as compared to the 7,280 projected in the program. It should also be noted that under the proposed program 36,400 cars will be installed during 5 years 1966 to 1970. If you add to this the 7,700 which will be installed in 1965, this brings the total to 44,100 which for the 6 year period is 38¼% of the estimated serviceable fleet as of the end of 1970.

Further, if we should install the 7,280 new freight cars in each of the 5 years and capitalize the cost of rehabilitation on the average of 7,400 cars a year and finance this requirement, over the next 5 years equipment expenditures alone would require a net increase in funded debt of between $400 and $500 million without the purchase of a single new locomotive. The proposed program, of course, naturally cannot give any consideration at the moment to our merger and integration of our fleet with that of the Central. Also, no consideration appears to be given to greater utilization of equipment through control of our computer system. Basically we believe that we should continue to work strenuously on a 5 year equipment program but that this should be done in conjunction with the Central and that we develop it based on our inventory of cars and theirs. However, we believe that some such basis as the following should be used to approximate our requirements.

We, in many respects, are similar to an industrial manufacturing company. Our product is revenue ton miles. Our fleet should be broken down by classes of equipment and a study should be made in the case of each class as to how many revenue ton miles in the past these cars have been capable of producing and allowing a factor for increased efficiency what eacb car acquired should mean in added revenue ton miles.

Another weakness in the present proposed program is that it deals only with the number of cars and give no recognition to increased capacity. By developing our requirements on this basis, we will also have a far better gauge as to our so-called manufacturing efficiency and we can see which classes of cars are showing increases in production of ton miles and which are showing decreases.

There are so many discrepancies in the proposed program that it appears that figures have almost literally been picked out of the air.

There is obviously no pressing need for immediate approval of a 5 year program. Even though we do not think much of the soundness of the program. I wish to reiterate that we consider it a major step forward. Immediate steps should be taken to get together with the Central and start developing a really sound program which will allow us to program our equipment building and financing on an even keel.

The equipment financial situation is very serious. Over a long period of years it can be easily demonstrated that the Pennsylvania spent (whether wisely or not) more money on its equipment than any other railroad in the United States. As a result, we are approaching a very serious situation where our annual equipment maturities very quickly are going to equal or exceed not only our equipment depreciation, but our total depreciation. This is almost unheard of in the railroad industry and unless corrected promptly will do more to hurt our credit than almost any other factor. If our credit is damaged this, in turn, will have a very serious and substantial effect on the value of our stock.

D. C. B.

ROADWAY AND EQUIPMENT EXPENDITURES

	3 years 1963–65			2 years 1964–65		
	Pennsylvania RR.	New York Central RR.	Pennsylvania RR. percent of New York Central	Pennsylvania RR.	New York Central RR.	Pennsylvania RR. percent of New York Central
Operating revenues	$2,605,905,258	$1,926,306,356	135.3	$1,765,793,604	$1,302,973,594	135.5
Gross ton-miles—Freight-passenger (thousands)	411,033,187	297,163,067	138.3	278,478,861	201,590,279	138.1
Equated track-miles (average)	16,152	14,148	114.2	16,042	14,039	114.3
Gross ton-miles per equated track-mile	25,448,000	21,004,000	121.2	17,359,000	14,359,000	120.9
Roadway expenditures:						
Operating expenses	$189,715,506	$160,802,129	118.0	$131,733,850	$107,170,336	122.9
Capital	92,756,000	49,001,000	189.3	79,151,000	34,800,000	227.4
Total	282,471,506	209,803,129	134.6	210,884,850	141,970,336	148.5
Equipment expenditures:						
Operating expenses	345,140,730	253,873,109	136.0	227,508,089	168,455,132	135.1
Capital (including lease obligations)	334,714,000	179,755,000	186.2	265,928,000	154,407,000	172.2
Total	679,854,730	433,628,109	156.8	493,436,089	322,862,132	152.8
Total expenditures:						
Operating expenses	534,856,236	414,675,238	129.0	359,241,939	275,625,468	130.3
Capital	427,470,000	228,756,000	186.9	345,079,000	189,207,000	182.4
Total	962,326,236	643,431,238	149.6	704,320,939	464,832,468	151.5

ROADWAY AND EQUIPMENT EXPENDITURES

	10 years 1956 to 1965			5 years 1961 to 1965	
	Pennsylvania RR.	New York Central RR.	Pennsylvania RR., percent of New York Central	Pennsylvania RR.	New York Central RR.
Operating revenues	$8,830,767,173	$6,705,596,213	131.7	$4,276,702,023	$3,160,859.438
Gross ton miles—Freight-passenger (thousands)	1,357,739,676	1,030,868,974	131.7	664,781,526	489,267,507
Equated track miles (average)	16,717	15,330	109.0	16,364	14,417
Gross ton miles per equated track mile	81,219,000	67,245,000	120.9	40,625,000	33,937,000
Roadway expenditures:					
Operating expenses	680,023,796	563,079,738	120.8	306,008,675	264,603,061
Capital	211,304,000	185,469,000	113.9	116,083,000	77,316,000
Total	891,327,796	748,548,738	119.1	422,091,675	341,919,061
Equipment expenditures:					
Operating expenses	1,279,505,463	918,581,198	139.3	584,045,284	431,321,233
Capital (including lease obligations)	875,328,000	395,579,000	221.3	435,207,000	223,657,000
Total	2,154,833,463	1,314,160,198	164.0	1,019,252,284	654,978,233
Total expenditures:					
Operating expenses	1,959,529,259	1,481,660,936	132.3	890,053,959	695,924,294
Capital	1,086,632,000	581,048,000	187.0	551,290,000	300,973,000
Total	3,046,161,259	2,062,708,936	147.7	1,441,343,959	996,897,294

Exhibit 49

EQUIPMENT LEASE AGREEMENTS

Dated: Lessor/agent	Expiration date	Effective date (percent)	Original cost	Rent due after Dec. 30, 1970	Equipment covered: Passenger cars	Freight cars	Locos	Other	Renewal option
May 11, 1950: Equitable Life Assurance Society.	Aug. 3, 1975	(1)	$7,237,500	$374,865		1,324			None.
Aug. 8, 1950: Equitable Life Assurance Society.	Sept. 1, 1975	6.15	53,029,000	8,592,142		7,138			Do.
Sept. 1, 1950: Equitable Life Assurance Society.	Mar. 28, 1976	(1)	5,169,000	364,597		897			Do.
Nov. 1, 1950: Equitable Life Assurance Society.	May 25, 1976	(1)	5,281,000	367,462		900			Do.
Feb. 1, 1951: Equitable Life Assurance Society.	June 9, 1977	(1)	5,004,000	74,560		165			Do.
Mar. 1, 1952: Equitable Life Assurance Society.	June 25, 1977	(1)	2,903,500	33,852		70			Do.
Apr. 1, 1952: Equitable Life Assurance Society.	July 14, 1978	(1)	5,005,200	308,016		552			Do.
Feb. 1, 1956: Chase Manhattan Bank	Apr. 1, 1971	3.46	2,408,342	73,008			20		Do.
Nov. 1, 1957: Morgan Guaranty Trust Co.	Jan. 1, 1973	4.49	32,325,795	5,791,703			174		10 years.
Dec. 20, 1957: Manufacturers Hanover Trust Co.	July 1, 1973	3.79	5,866,375	1,778,435			25		Do.
Nov. 1, 1958: Greenville Steel Car Co.	Nov. 1, 1978	4.73	2,928,730	175,200		350			Do.
May 1, 1959: Morgan Guaranty Trust Co.	Dec. 31, 1979	4.37	18,350,000	5,447,812		1,958			Do.
May 15, 1959: First National City Bank.	Aug. 1, 1979	4.93	84,840,000	40,131,677		9,265			Do.
June 1, 1959: Harris Trust Co	Oct. 1, 1979	5.13	9,975,000	3,482,046		1,000			Do.
June 15, 1959: First National Bank of Chicago.	Nov. 1, 1979	4.63	16,354,000	6,249,317		1,700			Do.
Aug. 1, 1959: St. Louis Union Trust Co.	Feb. 1, 1990	5.50	3,567,000	2,928,355		299			None.
Nov. 1, 1959: Morgan Guaranty Trust Co.	Apr. 1, 1980	4.88	10,250,000	3,399,693		989			10 years.
Jan. 1, 1960: Morgan Guaranty Trust Co.	Mar. 1, 1980	5	39,800,000	25,229,239		3,931			Do.
Mar. 24, 1960: General Electric Co	Sept. 1, 1978	5.38	32,699,634	18,506,871			66		Do.
May 31, 1960: First National City Bank.	May 31, 1980	5.38	3,106,600	1,475,635				[2] 7	5 years.
May 23, 1961: Port of New York Authority.	Dec. 15, 1987	2.72	8,165,172	7,014,523	53				25 years.
Apr. 24, 1962: City of Philadelphia	Apr. 24, 1991	3.75	4,868,653	3,917,020	17				None.
Sept. 24, 1963: Port of New York Authority.	Feb. 1, 1989	2.72	2,400,000	5,520,240	34				24 years.
Sept. 30, 1963: Chase Manhattan Bank	Dec. 1, 1983	4.38	6,400,000	4,999,819	50				None.
Dec. 16, 1963: Chase Manhattan Bank.	Sept. 1, 1979	4.63	27,503,347	14,671,773	109	3,531			Do.
Jan. 21, 1964: Chase Manhattan Bank.	Jan. 1, 1972	4.63	474,349	93,054		23			Do.
Feb. 14, 1964: National Bank of Detroit.	Feb. 15, 1972	4.50	900,504	175,518				[3] 127	Do.
Mar. 11, 1964: Chase Manhattan Bank.	Jan. 1, 1972	4.63	422,552	82,893		30			Do.

EXHIBIT 49—Coutinued

EQUIPMENT LEASE AGREEMENTS

Date: Lessor/grant	Expiration date	Effective (percent)	Original cost	Rent due after Dec. 30, 1970	Equipment covered: Passenger cars	Freight cars	Locos	Dther	Renewal option
Nov. 30, 1964: National Bank of Newark.	Nov. 30, 1979	4.63	$1,418,496	$1,069,722	10				10 years.
Dec. 18, 1964: City of Philadelphia	Dec. 18, 1989	3.75	9,250,441	9,834,966	38				None.
Feb. 1, 1965: First National City Bank.	May 27, 1980	4.73	5,458,860	4,078,400			25		10 years.
Mar. 26, 1965: National Commercial Bank & Trust Co.	Sept. 7, 1973	4.90	1,711,350	652,254		461			None.
Apr. 1, 1965: Morgan Guaranty Trust Co.	Apr. 1, 1980	4.85	22,440,300	16,846,647			99		10 years.
Apr. 1, 1965: Pittsburgh National Bank.	Dec. 18, 1977	4.20	3,966,000	2,769,410		487			5 years.
Apr. 15, 1965: Morgan Guaranty Trust Co.	May 1, 1980	4.85	5,651,684	4,241,589			25		10 years.
Apr. 23, 1965: Continental Illinois National Bank.	Oct. 10, 1979	4.87	1,657,128	1,226,367		381			None.
May 25, 1965: First National Bank of Cincinnati.	Dec. 31, 1975	4.04	3,107,916	1,616,270		561			5 years.
May 20, 1965: First National Bank of Chicago.	Dec. 18, 1977	4.20	4,637,885	3,153,010		497			Do.
June 22, 1965: Huntington National Bank.	Mar. 8, 1978	4.52	2,463,468	1,980,467		294			4 years.
June 30, 1965: National Bank of Indianapolis.	Aug. 28, 1980	3,23	3,112,764,	2,490,091			15		None.
July 30, 1965: Manufacturers National Bank, Detroit.	Dec. 14, 1980	3.46	3,286,526	2,366,298			15		Do.
Aug. 6, 1965: First National Bank of Cincinnati.	Dec. 26, 1975	3.90	851,788	482,265		87			5 years.
Sept. 15, 1965: Merchants National Bank of Indiana.	Dec. 26, 1980	3.41	2,813,180	1,746,740			10		None.
Sept. 20, 1965: American National Bank & Trust Co.	Dec. 27, 1977	3.75	2,181,000	1,716,869		295			5 years.
Nov. 15, 1965: Chase Manhattan Bank	Dec. 31, 1980	3.74	5,460,572	4,289,820			25		None.
Dec. 15, 1965: National Boulevard Bank of Chicago.	Mar. 12, 1978	3.95	805,406	628,128		187			Do.
Dec. 15, 1965: National Bank of Detroit.	Apr. 26, 1978	3.95	805,406	628,128		189			Do.
Feb. 1, 1966: First National Bank of Erie.	May 29, 1978	4.92	402,703	304,642		96			Do.
Mar. 15, 1966: First National Bank of Chicago.	July 27, 1978	4.24	3,690,000	3,241,980		437			Do.
Mar. 24, 1966: Equitable Life Assurance Society.	Oct. 30, 1978	4.78	10,783,000	8,601,943		1,384			Do.
Sept. 8, 1966: Northern Trust Co.	Nov. 26, 1978	5.32	3,052,000	2,553,504		389			Do.
Sept. 15, 1966: Chemical Bank	Dec. 13, 1986	4.20	8,936,240	10,031,193		482			Do.
Jan. 16, 1967: U.S. Railway Equipment Co.	Mar. 22, 1975	4.48	2,237,500	1,481,896		489			5 years.
May 22, 1967: Continental Illinois National Bank.	Dct. 31, 1979	4.49	1,625,000	2,886,120		391			None.
May 23, 1967: Fidelity Bank	July 24, 1979	4.74	2,331,250	3,018,025		245			Do.
June 1, 1967: Irving Trust Co	Sept. 17, 1982	5.27	11,205,800	11,387,512			50		Do.
Aug. 11, 1967: U.S. Leasing International, Inc.	Sept. 28, 1979	5.32	4,029,250	3,775,941		246	20		Do.
Oct. 16, 1967: Equitable Life Assurance Society.	Dec. 2, 1977	4.67	3,000,000	2,050,119		398			2 years.
Dct. 20, 1967: U.S. Leasing International, Inc.	May 20, 1982	4.28	11,407,009	11,215,942			50		None.
Dec. 1, 1967: C.I.T. Corp	Jan. 13, 1983	5.69	14,162,384	22,192,194			50		Do.
Dec. 1, 1967: U.S. Leasing International, Inc.	Jan. 17, 1980	4.28	3,107,000	3,128,825		492			Do.
Dec. 1, 1967: U.S. Leasing International, Inc.	Jan. 17, 1980	5.27	2,520,000	2,656,080			30		Do.
Dec. 1, 1967: U.S. Leasing International, Inc.	Jan. 29, 1980	5.13	5,785,800	5,178,642		598			Do.
Oec. 1, 1967: First Pennsylvania Bank.	Jan. 13, 1983	5.69	11,205,012	14,382,169			50		5 years.
Jan. 2, 1968: U.S. Leasing International, Inc.	Feb. 21, 1988	5.12	881,000	1,149,225		50			None.
Mar. 1, 1968: Provident National Bank.	Feb. 1, 1976	7	1,689,432	1,312,768				[3] 227	Do.
May 15, 1968: American Security & Trust Co.	May 6, 1976	7.50	321,668	266,480				[3] 51	Do.
May 12, 1968: American Security & Trust Co.	May 16, 1976	6.50	841,943	431,012				[3] 126	Do.
Aug. 1, 1968: U.S. Leasing International, Inc.	Dec. 31, 1980	5.31	1,995,000	2,115,400			12		Do.
Aug. 15, 1968: U.S. Leasing International, Inc.	Mar. 12, 1983	5.3	1,384,391	1,913,243			13		5 years.
Aug. 15, 1968: Mercantile Safe Deposit & Trust Co.	Sept. 15, 1983	5.94	21,476,713	29,422,538			89		Do.
Aug. 15, 1968: U.S. Leasing International, Inc.	June 10, 1980	5.75	6,283,000	6,528,533		594			None.
Dct. 10, 1968: U.S. Leasing International, Inc.	Oec. 20, 1968	5.60	3,218,000	3,217,640		326			Do.
Dct. 15, 1968: Merchants Despatch Trans. Corp.	Dct. 14, 1976	7.75	674,700	807,669				[3] 90	Do.
Dct. 15, 1968: New England Merchants National Bank.	July 1, 1983	5.70	5,058,940	6,729,432			20		Do.

EXHIBIT 49—Continued

EQUIPMENT LEASE AGREEMENTS

Date: Lessor/grant	Expiration date	Effective (percent)	Original cost	Rent due after Dec. 30, 5970	Equipment covered: Passenger cars	Freight cars	Locos	Other	Renewal option
Oct. 15, 1968: New England Merchants National Bank.	Dec. 15, 1988	5	$16, 393, 171	$25, 577, 183	49				10 years.
Nov. 1, 1968: Mercantile-Safe Deposit & Trust Co.	Jan. 15, 1984	5. 70	13, 217, 570	18, 942, 717			55		None.
Nov. 1, 1968: C.I.T. Corp	Jan. 15, 1984	6	13, 217, 570	18, 905, 415			55		Do.
Nov. 1, 1968: Merchants Despatch Trans. Corp.	Dec. 19, 1976	7	1, 063, 240	1, 151, 221				[3] 185	Do.
Nov. 13, 1968: U.S. Leasing International, Inc.	Dec. 20, 1980	6. 43	3, 521, 400	3, 593, 128		198			Do.
Nov. 10, 1968: Fidelity Bank	Jan. 1, 1981	6. 56	2, 191, 026	3, 550, 772		282			Do.
Jan. 9, 1969: Merchants Despatch Trans. Corp.	Dec. 31, 1976	7. 50	1, 642, 576	2, 037, 744				[3] 212	Do.
Feb. 1, 1969: Merchants Despatch Trans. Corp.	June 15, 1977	7. 50	995, 300	1, 306, 305				[3] 130	Do.
Mar. 10, 1969: Merchants Despatch Trans. Corp.	Apr. 30, 1977	8. 25	797, 895	1, 208, 130				[3] 136	Do.
Apr. 25, 1969: Bankers Trust Co	May 15, 1981	8. 75	15, 404, 260	19, 416, 000		1, 240	30	[4] 10	Do.
May 15, 1969: Chemical Bank	Nov. 15, 1978	8. 25	11, 613, 550	13, 660, 000		1, 487		[4] 74	5 years.
June 9, 1969: U.S. Leasing International, Inc.	Dec. 2, 1987	8. 12	12, 082, 257	20, 930, 093			60		None.
Aug. 1, 1969: C.I.T. Corp	Dec. 11, 1984	7. 39	16, 188, 478	29, 262, 913			79		3 years.
Sept. 15, 1969: C.I.T. Corp	Oct. 14, 1984	6. 26	7, 483, 502	11, 542, 904		265			None.
Dec. 11, 1969: C.I.T. Corp	Dec. 1, 1984	6. 28	5, 000, 285	8, 875, 921		246			25 years.
Jan. 10, 1970: Ford Motor Credit Co	Jan. 30, 1985	8. 63	19, 193, 503	34, 139, 688		8669			15 years.
Mar. 1, 1970: First Pennsylvania Bank.	Apr. 28, 1985	7. 60	16, 278, 810	26, 548, 574		909			Do.
Nov. 3, 1970: Mercantile-Safe Deposit & Trust Co.	May 15, 1985	7. 40	26, 405, 373	44, 208, 845			112		5 years.
Dec. 5, 1970: EL–PC Leasing Corp	Dec. 15, 1985	7. 27	30, 000, 000	50, 734, 570			137		10 years.

[1] These agreements are presently on an extended term at the nominal rate of $0.20 per car per day.
[2] Tugs.
[3] Racks.
[4] Work.

Note: $61,917,051 will be paid in rent due during 1971 under the foregoing agreements.

Exhibit 50

November 21, 1966.

S. T. S.: Any sound comparison of the earnings of the Pennsylvania Railroad and the New York Central can only be made if it is fully realized and recognized that qualitatively there is a very substantial difference in composition. Basically, from a policy standpoint, there are two perfectly proper approaches to the income statement which may be made by any top management.

1. A policy may be instituted of attempting as far as possible to keep net income and cash flow as closely together as possible without regard to what the immediate effect is on earnings. Up to several years ago this was basically the policy pursued by the Pennsylvania Railroad.

2. The policy may be instituted of maximizing earnings to the greatest extent possible within the limits of good accounting practices. In the last several years this has been done on the Pennsylvania in accordance with your expressed desires. It does mean, however, that we tend to create a wider and wider difference as between reported income and cash flow. Today the cash flow of the Pennsylvania Railroad is substantially less than its reported income. We changed the basis of consolidation and, therefore, a substantial amount of earnings of subsidiaries are now included in our reported income but are not actually available to us from the standpoint of dividends. We were the first railroad in the United States to capitalize overhead in conjunction with capital expenditures and numerous other changes have occurred.

Over the short term today the New York Central earnings as reported are much more real and tangible from the standpoint of an ability to pay dividends than are those of the Pennsylvania. Virtually all of their earnings are actually available for the payment of dividends, i.e. the rentals received from real estate are in no way required to be ploughed back into the existing properties in order to have them maintained. These are net rentals and are available immediately for dividend payments. On the other hand, much of Pennsylvania Railroad's income is in this form of income of subsidiary companies which, in turn, have their own requirements for the plough back of money. From the longer term standpoint our situation is better. New York Central rentals are subject to the full corporate income tax of 48% and as a consequence, New York Central operating by itself will run out of tax carry forward loss sooner than the Pennsylvania. We in turn pay only a 7.2% tax on dividends received from companies which are not our consolidated tax return and it will be a long time before we by ourselves would have to pay taxes.

Examining the statement attached on a consolidated basis, there is very little to choose between our respective payouts. Currently, based on our 1966 assumptions on a

consolidated basis, we will pay out a slightly higher percentage but not significantly. However, the real test is in the payout of the Pennsylvania Railroad itself as contrasted with New York Central and this is where the ability to pay is crucial. You will note that over the six year period we have paid out over 75% of our earnings. The same is true for five years and for the latest three years it will be over 70%. As contrasted to this, New York Central's percentage has ranged from 48% or less than half down to a three year average of about 40%. When these facts are borne in mind, it is easy to see that New York Central is paying dividends well within its capacity whereas in the case of Pennsylvania, we are stretching our financial resources to the limit.

1. Our maturities equal our total depreciation as against New York Central maturities equaling about only one-half their total depreciation.

2. Our capital expenditures over a long period of time are almost double those of the New York Central.

3. Their percentage of payout in dividends is far below that of the Pennsylvania Railroad and far more conservative.

D. C. B.

DIVIDEND PAYOUT

Year	Company: Net income	Company: Dividend	Company: Percent payout	Consolidated: Net income	Consolidated: Dividend	Consolidated: Percent payout
Pennsylvania RR.:						
1961	$3,515,586	$3,291,939	93.64	$17,229,491	$3,291,939	19.11
1962	(3,209,885)	3,362,289		20,522,243	3,362,289	16.38
1963	9,158,870	6,755,458	73.76	31,834,930	6,755,458	21.22
1964	29,132,927	17,176,338	58.96	60,097,048	17,176,338	28.58
1965	33,896,504	27,661,346	81.61	70,113,462	27,661,346	39.45
1966	[1] 45,000,000	[1] 31,250,000	69.44	[1] 90,000,000	[1] 31,250,000	34.72
Averages:						
6-year average (1961–66)	19,582,334	14,916,228	76.17	48,299,529	14,916,228	30.88
5-year average (1962–66)	22,795,683	17,241,086	75.63	54,513,537	17,241,086	31.63
3-year average (1964–66)	36,009,810	25,362,561	70.43	73,403,503	25,362,561	34.55
1961	(12,549,048)			(10,334,489)		
1962	(3,835,538)	2,126,642		210,218	2,126,642	1,011.64
1963	7,039,843	3,271,414	46.47	13,825,544	3,271,414	23.64
1964	27,046,846	11,798,258	43.62	35,511,376	11,798,258	33.22
1965	41,518,728	17,725,564	42.69	52,355,635	17,725,564	33.86
1966	[1] 58,000,000	[1] 22,200,000	38.28	[1] 69,000,000	[1] 22,200,000	32.17
Averages:						
6-year average (1961–66)	19,536,805	9,520,313	48.73	26,761,381	9,520,313	35.57
5-year average (1962–66)	25,953,976	11,424,376	44.02	34,180,555	11,424,376	33.42
3-year average (1964–66)	42,188,525	17,241,274	40.87	52,289,004	17,241,274	32.97

Note: Assumptions for 1966—Pennsylvania RR. dividend—85 cents in December, $2.25 for year. New York Central earnings: consolidated at $10 per share with subsidiaries contributing approximately same as in 1965 ($10,800,000). Dividends: December dividend 1.3 times Pennsylvania RR. or $1,105, total for year, $3,225.

[1] Estimate.

PENNSYLVANIA CO. DIVIDEND INCOME

	1965: Rate	1965: Amount	1966: Rate	1966: Amount	1967: Rate	1967: Amount
Buckeye Pipe Line Co.		$5,965,000		$5,555,000		$5,600,000
Detroit, Toledo & Trenton RR. Co.	$15.45	3,527,425	$12.40	3,042,080		
Great Southwest Corp. preferred			(1)	87,500	(1)	210,000
Macco Realty Co., preferred			(1)	1,040,480	(1)	2,362,242
Norfolk & Western Hy. Co. common [2]	6.50	15,228,096	6.50	15,068,096	$6.50	14,428,096
Toledo, Peoria & Western RR. Co.	5.00	225,000	5.00	225,000	5.00	225,000
Wabash RR. Co. common [3]	22.84	13,595,181	19.25	11,458,659	15.30	9,107,402
Other [4]		4,893,624		4,608,368		4,593,915
Total		43,434,386		41,085,183		36,526,655

[1] Six percent.

[2] Interest—N. & W. debentures: 1966, $120,250; 1967, $761,577.

[3] Includes special dividends account:

	1965: Rate	1965: Amount	1966: Rate	1966: Amount	1967: Rate	1967: Amount
D.T. and I. stock	$7.94	$4,725,881				
Ann Arbor stock	1.25	744,069	$3.75	$2,232,206		

[4] Principally leased line stocks and Wabash preferred.

	1964	1965	1966 (estimated)
1. Net income, Pennsylvania Railroad Co	$29,133,000	$33,897,000	$45,000,000
2. Total capital expeditures	100,843,000	244,236,000	185,000,000
3. Capital expenditures, financed	53,073,000	226,276,000	127,524,000
4. Capital expenditures, cash	47,770,000	17,960,000	57,476,000
5. Outstanding debt	933,930,000	1,188,409,000	1,290,800,000

EXHIBIT 51

MEMORANDUM

Date: September 12, 1969.
To: Mr. David C. Bevan.
From: William C. Baker.
Subject: Tax Allocation Agreement Between GSC and Penn Central Company.

In preparing our new Form S-1 Registration Statement, it was necessary for our counsel to review the subject Tax Allocation Agreement in order to fully disclose its terms and its effect upon GSC's tax picture. This led us to a reexamination of the reasons and business justification for the existence of such Agreement between our two companies, and raised certain new issues which I now consider to be very pressing.

While I was not actually a director of GSC at the time its Board approved this Agreement, our files indicate the possibility that insufficient facts were known to such directors, and insufficient consideration was given by them, to the business justifications for, and the consequences of, such Agreement, prior to their approval of same. This is not to say, and I certainly do not contend, that such Agreement was improperly or inadvisedly approved, in light of the then existing circumstances, or that compelling reasons do not still exist which justify and/or require its continued existence. As you well know, we clearly recognize the Penn Central's ownership and control of GSC, and readily acknowledge that there may be facts and circumstances unknown to us which absolutely require Penn Central's imposition of this Agreement upon GSC. However, if there are no such compelling unknown reasons, and if the continued existence of this Agreement is a matter which rests within the sound business judgment of the GSC management, I seriously believe that the matter requires further examination and consideration, in the light of subsequent events, new legal authorities furnished us by counsel, and the possibility of new developments in GSC's tax picture. For that reason, I submit herewith our most recent findings and conclusions, including the latest findings of our legal counsel, and respectfully request your careful consideration of the issues herein raised.

Prior to original GSC Board approval of the Agreement, attention was given, and counsel's opinion was sought and obtained, as to whether, in approving and executing such an Agreement, the directors of GSC, and Penn Central, in its capacity as majority shareholder, would satisfy their respective fiduciary responsibilities to the minority shareholders of GSC. The GSC Board had been furnished a legal opinion on the subject by the New York law firm of Sullivan & Cromwell dated April 24, 1968, which specifically dealt with, and relied upon, an almost identical agreement theretofore approved by the New York Courts between Mahoning Coal Railroad Company and the New York Central Railroad Company; such case being styled *Case v. New York Central Railroad Company*, 15 N. Y. 2d. 150 (1965). By the same token, the GSC Board sought and obtained an opinion of its own corporate counsel. Both opinions reached the same conclusion, i.e, that the Penn Central would not be taking "undue advantage" of its position as majority shareholder in executing the Agreement, and that the directors of the subsidiary would not thus violate their obligations of good faith and reasonable care in the discharge of their duties if they approved and executed such agreement *"in the exercise of their reasonable business judgment."*

I quote and emphasize this last phrase because the identical language was used by both law firms in their opinions and in arriving at their conclusion. It is now my sincere belief that subsequent events, both of a business and corporate nature, as well as recent tax developments and legislative proposals, have cast considerable doubt upon whether the Tax Allocation Agreement between the Penn Central Company and GSC is any longer supported by "reasonable business judgment," whether certain factual assumptions made by the aforesaid legal counsel still exists, whether the Penn Central Company would still be held (by a court) not to be taking "undue advantage" of its position as majority shareholder of GSC, and whether the directors of GSC have sufficient factual data upon which to exercise their "reasonable business judgment" in this regard.

For example, and taking these issues in inverse order, the Sullivan & Cromwell Opinion noted that while the New York Court in the *Case* suit did not expressly make its holding dependent upon a finding that the parent would have subsequent income against which the losses for which it was being paid could be offset, the court nevertheless suggested, and Sullivan & Cromwell concluded, that whether the advantage realized by the parent from payment by the subsidy for use of its losses was permanent or illusory might well depend upon there being a substantial certainty of the parent's future tax liability increasing by an amount at least aqual to the subsidiary's payments. In other words, the Court referred to the parent's losses, which it was allowing the subsidiary to utilize, as a "potential asset" to Central and assumed (as did Sullivan & Cromwell) that no loss carryovers

of the Penn Central affiliated group would expire if the income of the affiliated subsidiaries with substantial minorities were excluded. Stated another way, an intermediate New York Court had reached an opposite result in the *Case* suit, because "although the use of Central's losses to offset Mahoning's profits deprived Central of their availability for carryforward or carryback purposes, it seemed unlikely at the time that Central would have sufficient profits in the foreseeable future to necessitate carryforward of present losses for tax liability to be avoided. Absent the expectation of future profits, the consolidated return provided immediate gain without attendant risk of future loss." See 77 Harvard Law Review 1142 (1964).

Therefore, apparently the New York Court in the *Case* suit, and certainly Sullivan & Cromwell, concluded that the parent's reasonably certain future profit situation was an important factor in determining whether or not the Agreement was fair and just to the subsidiary's minority shareholders. In this connection, we have no data from which to answer this question. GSC has never been told, or even given a real estimate, indicating how long the tax loss carryover will last, or how long such loss benefits might be available to GSC. This leads us to the conclusion that the GSC directors were and are lacking facts which the New York Courts and Sullivan & Cromwell considered to be a very important consideration in determining whether the execution of such an Agreement was the exercise of "reasonable business judgment."

Quoting further from Sullivan & Cromwell, its writer voiced his belief that the Penn Central Directors would be derelict in their responsibility if they did not insure that it would receive "adequate compensation" for the utilization of a group asset (the tax loss carryovers) from subsidiaries having substantial minority interests. I quote this comment to emphasize that the writer of such opinion did not imply any duty on the part of Penn Central to *sell* its "potential asset" (the tax loss carryover) to its subsidiaries, or to receive a cash payment therefor, but only that they had a duty to insure receipt of "adequate compensation." This naturally raises the question of just what constitutes "adequate compensation" to Penn Central for GSC's use of the consolidated group's tax shelter position, and I suggest the distinct possibility that adequate compensation to Penn Central can better be obtained by outright elimination of the agreement, as opposed to its continued imposition upon GSC. As just one illustration, GSC stock has been selling since July 1st. of this year at an average price of $29.25 per share. Most, if not all analysts, agree that the market value of a stock is ordinarily determined by capitalization of after-tax earnings. GSC's after-tax earnings for the six-month period ended June 30, 1969, were released to the press as $20,700,689 (or $.68 per share); producing a price-earnings ratio of 43 to 1, considering only these six-months earnings and the ensuing market price. Therefore, assuming $55,000,000 pre-tax earnings in the year 1969, and $36,000,000 after-tax earnings under the present tax allocation agreement in the same year, the market price of the stock (using only the same multiple of 43 times after-tax earnings) could well reach $53.00 per share. On the other hand, if the tax allocation agreement were lifted this year, and *pre-tax* earnings (or non-taxable earnings) were capitalized at the same multiple, the minority shareholders market equity could well increase from $239,400,000 to $365,900,000 (at a price per share of $53 and $81 respectively).

Further, the Penn Central's own market equity in GSC stock could well increase from $1,189,394,000 to $1,817,753,000. (Assuming the above-cited per share figures and total conversion of Penn Central's convertible notes). Now, of course, this would not increase the balance sheet assets of the Penn Central, because of its inability to write up its investment in the stock to its increased market value. However, I would remind you that, as a result of the acquisition of Macco by GSC, Penn Central now owns or controls, or has the right to own or control, some $5,000,000 shares of GSC stock more than is necessary for it to file consolidated tax returns, and for it to retain absolute voting control of the corporation. This fact presumably, allows Penn Central eventually to sell off, by way of secondary offering, or otherwise, some $405,000,000 of GSC stock and still retain 80% ownership of such subsidiary, assuming such an increase in its market equity.

While not trying to tell the Penn Central Directors how to run their company, or how to exercise their own business judgment, I do seriously question whether Penn Central would be more "adequately compensated" by this result, and its possible realization of $405,000,000 actual cash receipts; as opposed to leaving the tax allocation agreement in effect which can reasonably be expected to realize Penn Central, upon sale of the same amount of stock, a probable maximum of $265,000,000, plus a paper account receivable from GSC of approximately $19,000,000 which GSC is certainly not in a position to pay at the present time.

I have heretofore quoted the observation of Sullivan & Cromwell that Penn Central would be derelict to its own shareholders if it failed to receive "adequate compensation" for allowing its subsidiaries use of this "potential asset" of tax loss carryovers, solely for the purpose of showing that its application to our relationship does not necessarily, if at all, require the imposition of the Tax Allocation Agreement upon GSC. In so doing, I did not intend to, and emphatically do not, accept, adopt or agree with such conclusion voiced by the writer of that opinion. I have great respect for the firm of Sullivan & Cromwell, which is very competent, capable, and distinguished. However, you will note that the particular conclusion in question was gratuitously inserted in the opinion and was not supported by the citation of any authorities. In reconsidering this Agreement, and the question of its reasonableness under present circumstances, we have had counsel research this point and have found competent judicial authority which not only casts considerable doubt upon the said conclusion, but one case which flatly contradicts the *Case* decision and reaches the exact opposite result.

In *Alliegro v. Pan American Bank of Miami*, 136 So. 2d 656, cert. den. 149 So. 2d 45, the Florida Appellate Court held that the payment of tax benefits by a profit-subsidiary to its loss-parent was the equivalent of illegal dividends which could not be paid to the exclusion of minority shareholders, or without their unanimous consent.

In the case of *Meyerson v. El Paso Natural Gas Company*, 246 A. 2d 786 (1967), the Delaware Chancery Court reviewed the *Case* decision, the Alliegro decision, and the case of *Western Pac. R. R. Corp. v. Western Pac. R. Co.*, 197 F. 2d 994, stating that they were the only authorities dealing with the question of the right of a "loss" corporation to participate in tax savings resulting from the filing of consolidated income tax returns. Meyerson was a case where El Paso Natural Gas Company (a profit-parent), owning in excess of 80% of the common stock of Northwestern Production Corp. (a loss-subsidiary), filed consolidated income tax returns which resulted in substantial tax savings, all of which were retained by El Paso. A minority shareholder of Northwestern brought suit for an accounting of such tax savings and for the imposition of a fair allocation agreement between El Paso and Northwestern. The Court denied the plaintiff any relief primarily because it was held to be beyond the power of a court to create an agreement between the two parties, and also because it was said to be the sole function of a court in such a dispute to determine the "fairness" of any such agreement already made. The Delaware Court agreed with the Ninth Circuit Court of Appeals in the *Western Pacific* case (see following page) that the test to be applied. in all such situations, is one of "fairness" and, in analyzing *Case v. New York Central Railroad Company* (cited and relied upon by the Sullivan & Cromwell Opinion) concluded that the New York Court reached its result because the "majority felt itself unable to say what would be a fair proportion of the distribution of Central's tax loss looking forward from the date of judgment." In other words, the Delaware Court concluded (unlike Sullivan & Cromwell) that the New York Court had not just put its stamp of approval, per se, upon the legality of the Central-Mahoning Agreement, but had merely refused to rescind the subject agreement, as requested by the plaintiff, because the record was totally devoid of any evidence to indicate that the "stronger side" (Central) had taken from the "weaker side" (Mahoning) its advantage by reason of its stock control and domination. However, the Court noted that two justices in the *Case* decision had dissented, commenting that the agreement was obviously not the result of a "arm's-length transaction". By the same token, the Delaware Court itself noted that it also found the "arm's-length, measure unacceptable in the parent-subsidiary relationship."

The case of *Western Pac. R.R. Corp. v. Western Pac. R. Co.*, 197 F. 2d 994, cited and relied upon by the Delaware Court in the *Meyerson* case, was decided by the United States Court of Appeals for the Ninth Circuit on October 29, 1951. The case is certainly not directly in point with our situation because of a very unusual, and even bizarre, set of facts. There, a parent corporation had filed consolidated income tax returns over a period of years for itself and certain of its affiliates, including the defendant corporation, the stock of which had been owned 100% by the parent. The net operating loss and tax loss carryovers of the parent and certain of its other affiliates, on a consolidated return basis, resulted in several millions of dollars in tax savings to the defendant subsidiary corporation (which I again remind you was wholly owned by the parent corporation). Through a very complex set of circumstances (involving the bankruptcy of the wholly owned defendant subsidiary, the parent's loss of its stock interest in such defendant subsidiary by reason of it being ruled worthless in the bankruptcy reorganization proceeding, and a subsequent very substantial financial rehabilitation and recovery of the defendant subsidiary as an active operating company), the court-appointed receiver for the parent corporation, and certain of its shareholders, later filed an action against the rehabilitated former subsidiary, claiming that the parent was entitled to be compensated or reimbursed by the former subsidiary for the tax savings it had achieved by use of the parent corporation's tax losses during the affiliated and consolidated tax return periods. While no fraud, deceit or over-reaching was alleged by the plaintiffs, they did contend, among other things, that there were certain dual officers of both the parent and the subsidiary who were derelict in their duties to the parent by filing consolidated returns, and by failing to exact an agreement from the subsidiary requiring the payment of money to the parent as a condition to the filing of such consolidated returns. In other words, the Plaintiffs made the exact contention as Sullivan & Cromwell, i.e., that the tax loss carryover of a parent made available to a profit-subsidiary results in the loss of a "potential asset" of the parent, for which the subsidiary should be required to compensate the parent. The plaintiffs in this case were denied any recovery or reimbursement whatsoever and the Court, in a lengthy opinion, made several observations and comments which are directly pertinent to the points now being raised here. For instance, the Court noted that the consolidated returns had been filed by the parent for *itself*, as well as its subsidiaries, and under the guidance of independent tax experts employed by the parent; noting that here, as in the usual case, the tax saving which a profit-subsidiary gains by such transactions will inure to the parent by way of increasing the value of its stock and/or by way of dividends. However, the plaintiffs contended specifically that the parent, being under no obligation to file consolidated returns, could have demanded that the defendant subsidiary enter into an agreement to pay the parent a sum of money as a prerequisite to the filing of such returns, and that the failure of the dual officers to exact such an agreement from the subsidiary was a breach of their obligation to the parent, and "unfair" to the parent's shareholders. In making such assertions, the plaintiffs cited three decisions of the Securities and Exchange Commission in support of their views that the rationale of the tax laws requires that any benefits resulting from the tax loss should go to the parent.

In answer and rebuttal, the Ninth Circuit Court held that the three decisions of the

Securities and Exchange Commission not only wholly failed to support the plaintiffs' contention, but that all three decisions made clear that the company whose loss was utilized for the benefit of the group does *not* have a right to compensation from those who benefitted. The Court also said that such decisions presented "a decided view point that the tax savings from consolidated returns *shall not* be paid over to the parent if this would *in any way* endanger the position of the creditors of the subsidiaries." At this point, I would like to parenthetically point out that our present Tax Allocation Agreement was executed long prior to GSC's acquisition of Macco, and its resulting assumption of all of Macco's liabilities. Prior to the merger or acquisition, GSC's total indebtedness to creditors other than its Penn Central parent amounted to $56,155,000. At the present time, and having assumed all of Macco's liabilities, GSC's total indebtedness to creditors other than its Penn Central parent amounts to $157,472,351. Therefore, it can hardly be gainsaid that, in the light of subsequent developments, the imposition of the tax allocation agreement upon the present GSC clearly endangers the position of its creditors; of especially in view of our almost constant tenuous cash position.

The Ninth Circuit went on to make certain other general observations about the relationship of a parent and subsidiary, their fiduciary relationship one to the other, and the result and effect of filing or not filing income tax returns on a consolidated basis. While I hate to bore you with all of these quotas, since some of them only restate well settled corporate principles, I nevertheless believe that they deserve repetition here in this context, and I quote:

"The Corporation was the sole owner of the subsidiary's capital stock. As such it was under a duty to deal fairly with the subsidiary having full regard to the interests of the creditors and holders of other securities. Consolidated Rock Products Co. v. DuBois, 312 U.S. 510, 522, 61 S. Ct. 675, 85 L. Ed. 982. It owed a duty not to require its subsidiary to forego a legitimate tax saving and could not bargain to perform its duty. *A parent company is not acting in the best interests of its subsidiary when it seeks to appropriate to itself an advantage which the tax laws give the subsidiary.* (Emp. Supp.)

* * * * * * *

The dual officers owed fiduciary duties to both corporations to promote the interests of both and to obtain for each what it was entitled to under the tax laws. Under this state of facts these officers had a positive duty to make use of the loss as they did, that is, to offset the income of members of the affiliated group with deductible losses of other members . . . . Indeed, this very thing had occurred in previous years of the affiliation and [parent] had effected substantial tax savings (Def. Ex. 46) by reason of filing consolidated returns. The record is clear that on none of these occasions was tribute paid to a subsidiary which which had suffered a loss.

* * * * * * *

There is nothing in the Code or Regulations that compels the conclusion that a tax saving must or should inure to the benefit of the parent company or of the company which has sustained the loss that makes possible the tax saving.

* * * * * * *

If [parent] had required tribute as a condition of its cooperation, then it would have been acting with less than the required standard of fairness to the subsidiary's creditors." (Emp. Supp.)

The next factor bearing upon whether our execution of this Agreement is a reasonable exercise of business judgment, and whether same is fair and just to the minority shareholders, is again illustrated by a passage from the Sullivan & Cromwell Opinion which directly quotes an observation by the court in the *Case* suit, noting that a majority shareholder is required not to "use its power to gain undue advantage at the expense of the minority . . . and to follow a course of fair dealings toward minority shareholders in the way it [manages] the Corporation's business." I am confident that you realize I personally am not about to criticize Penn Central's management of GSC, vis-a-vis the minority shareholders or otherwise, to accuse it of being unfair to us or them, or to accuse it of trying to take any undue advantage. However, issues such as these *do* get examined in the context of assertions that can be made by a disgruntled minority shareholder, possibly in a shareholder's derivative action, and, as always in such situations, with the benefit of 20/20 hindsight.

Any such litigation would presumably be predicated upon an assertion by such a shareholder that the alleged 5% tax saving afforded GSC by filing consolidated Federal Income Tax returns with the Penn Central group, and utilizing the group's tax loss carryovers, is more than offset by the tax liability incurred by GSC in failing to avail itself of all possible tax savings in an effort to produce needed profits for its controlling shareholder. In any such suit, I would certainly testify that I have always been advised by officers of the Penn Central that I had a duty to avail myself of all tax minimizing devices possible, and that I have certainly never been coerced to produce profits at the expense of tax savings. However, and by the same token, I would have to admit under oath that GSC has always had, and we certainly value, an excellent day-to-day working relationship with our Penn Central parent, take great pride in our contributions to its earnings, and consistently make

every effort possible to increase that contribution. While such evidence should conclusively show that the Penn Central has never forced GSC, through its majority control, to produce profits against the best interests of the subsidiary's minority shareholders, I can nevertheless foresee a judge and/or jury concluding (with that famous 20/20 hindsight) that we, as officers and directors of GSC, had been guilty of a conflict of interest between our majority and minority shareholders, to the detriment of the minority. A perfect example of a transaction which might give rise to such a conclusion is the sale of the Georgia and Texas amusement parks. Although both sales made excellent sense, for all the reasons previously advanced to you, and while I have no reservations about their economic validity, a disgruntled minority shareholder could nevertheless easily argue that GSC, at the direct instance of the Penn Central, sold two of its substantial and profitable assets solely to produce substantial profits for its majority shareholders within given financial periods. In making the sales, and as a necessary consideration to the investing syndicates for achievement of such substantial profits, GSC gave up all depreciation which had theretofore been available to offset the income from such profitable and productive assets. Therefore, and again with the benefit of 20/20 hindsight, a group of minority shareholders could well argue that, not only was GSC's income from such assets reduced, but there was no longer available any depreciation whatsoever to offset such income; the result being that every dollar of the substantial tax savings that would otherwise be lost to the Internal Revenue Service by GSC (on a separate return basis), now amounts to a loss of 95 cents to Penn Central, at least in the form of an account payable (on a consolidated return basis), as a result of the Tax Allocation Agreement.

By the very nature of GSC's real estate operations, it operates in a constant tenuous cash position. This is nothing peculiar to us, but is a fact inherent in our business. Thus, the necessary effect of the Tax Allocation Agreement is to drain resources from one of the major earnings contributors to the consolidated group; thereby hindering and restricting its ability to continue being a major contributor of such earnings. As I noted earlier, if called upon immediately to pay its full account payable to the Penn Central, arising from the Tax Allocation Agreement, GSC would be unable to do so, because it just does not have the cash. By the same token, we are expected to independently finance our own operations insofar as possible, but, at the same time, our ability to do so is lessened by the fact that our balance sheet must show this resulting substantial account payable to our Penn Central parent. Again, therefore, I personally question whether, in the exercise of reasonable business judgment, this is proper utilization of group financial resources.

Heretofore, I have dealt with our current corporate structure, our existing Tax Allocation Agreement, previous opinions on the subject legal counsel, and with events occurring since the original execution of such Agreement. However, before closing, I would like to also call your attention to the possible or even probable consequences to GSC, and the effect of the Tax Allocation Agreement upon it, if the anticipated new tax legislation is enacted into law as now proposed. In that event, GSC will be subjected to added tax burdens, by the very nature of its business, illustrated by the following examples; certainly none of which were contemplated at the time the original Tax Allocation Agreement was executed.

a. The use of excelerated depreciation on new commercial property will be curtailed by termination of the use of the double declining balance method of depreciation. This will certainly have an extremely adverse effect on all new commercial properties owned and held by GSC, whether under lease or for investment purposes.

b. The depreciation recapture provisions are to be changed, with the result that substantially more ordinary income will be realized upon the sale of depreciated real property.

c. The proposed complete repeal of the investment credit would have increased GSC's tax liability by approximately $1,000,000 in 1968.

d. While it cannot be termed new tax legislation, the recent change in the IRS ruling on deduction of prepaid interest has already adversely affected GSC's ability to make and consummate certain profitable real estate transactions, both as vendor and vendee.

In conclusion, I want to again emphasize my awarenes sthat I am not privy to all the problems of the Penn Central which may bear upon this issue. On the other hand, Sullivan & Cromwell ,as well as the Courts of Florida, Delaware, New York, and the Ninth Circuit all agree that the real issue is one of "fairness", and leave the determination of that issue to the "reasonable business judgment" of the respectively concerned Board of Directors, in the exercise of their good faith and their use of reasonable care in the discharge of their duties. Therefore, unless there are compelling reasons not now known to me which offset or counterbalance the foregoing facts, circumstances, developments and authorities, I must personally question whether this Agreement constitutes the exercise of "reasonable business judgment" on the part of GSC, under present circumstances. At the very least, I think that the entire GSC Board must be advised of the possibility of this Agreement creating or giving rise to a potential conflict of interest, however remote. Therefore, I would certainly feel derelict in my responsibilities to our directors if the foregoing facts and conclusions were not promptly called to their attention, and would be strongly reluctant to take any action to perpetuate the existence of this Agreement without giving our Board adequate opportunity to reconsider their prior approval of same. In view of the foregoing, I sincerely hope that you will appreciate my position in this regard.

William C. Baker.

P.S. I apologize for the rough nature of this memorandum, which was hastily prepared upon short notice, and I will be happy to have same resubmitted in a more comprehensive and neater form, if you so desire.

EXHIBIT 52

JUNE 1, 1967.

MR. SAUNDERS: We spent virtually all yesterday afternoon reviewing the operations and results for the 2nd quarter. The situation is not good.

Starting with the Pennsylvania Railroad itself we had a deficit of $1,060,000 in April. We had forecast a profit of $1.3 million in May. It now appears tentatively that we are going to have a loss of $500,000. It is estimated that revenues will be $1.5 million less than anticipated and that operating expenses may be $300,000 over. The revenue figure is still not firm and it is possible it might be worse than this. On the other hand the estimate on expenses could be cut somewhat by decreases in maintenance work, M. of E. or M. of W. At the moment, we are using the June estimate of $3,260,000. However, with the current trend in revenues and expenses this appears optimistic unless it is possible to make very substantial reductions in maintenance expenses. On this basis, before adjustments Pennsylvania Railroad will then have earnings of $1.7 million in the 2nd quarter.

In reviewing the severance pay situation and making charges to income only on the basis of actual cash payments made, we can come up with a credit of $360,000 on severance pay in view of the fact these payments will not be made until July, and applying the same policy to net charges, we can pick up another $879,000, or a total of $1,239,000. This will give us income of $2,939,000 in the 2nd quarter as compared to $13,001,600 in the 2nd quarter of last year, or a decrease of 77.4%.

Turning to the consolidated picture, we have a possible credit in Buckeye of $932,000 which is being reviewed and we hope that it can be used, increases of $61,000, for D.T.&I. and $130,000 for Great Southwest, giving total adjustments if the $932,000 holds up of $1,123,000. Arvida had already been improved by $35,000 and it is possible we may get some small additional improvement. With the $9,932,000 previously forecast plus the $1,123,000 discussed above we come up with a figure of $11,086,000. It should also be noted that in the $9,963,000 of other income we are including about $880,000 as a result of the contemplated sale of additional Wabash to maximum extent possible. The $11,086,000, compares with $12,725,000 in the 2nd quarter of last year, a decrease of 12.9%. The two areas in which we are most hurt in other income are Macco and D.T.&I.

On this basis we would have for the 2nd quarter consolidated income of $14,025,000 as compared to $25,726,000 for the 2nd quarter last year, a decrease of 45.5%. Comparison of figures for the 1st quarter, 2nd quarter and the 6 months with comparable periods last year and the percent of decline are set forth in the attached table.

This is not a particularly bright picture but my guess is that it will compare favorably with that of other Eastern railroads. We have included everything that we can think of in the parent company and consolidated, and we know of no other steps to take from an accounting standpoint. We have pushed credits and revenues to the limit. As indicated previously, I think the only possible way at this late date to improve the situation is for very drastic cuts in maintenance, if this is feasible. Actually this is undoubtedly going to have to be done to make the June figures.

DAVID C. BEVAN.

EXHIBIT 53

LABRUM & DOAK,
Philadelphia, Pa., February 15, 1972.

MR. GEORGE DELLER,
Six Penn Center Plaza,
Philadelphia, Pa.

DEAR MR. DELLER: Enclosed herewith are David Bevan's answers to the questions which you left with me the other day. We have added two paragraphs in connection with the pension fund and have attached certain enclosures referred to in the answers.

Very truly yours,

LABRUM & DOAK,
By EDWARD C. GERMAN.

[Enclosures.]

ANSWERS OF DAVID C. BEVAN

1. Q. What was the dividend policy of the PRR, PCTC and the Penn Central Co?

A. The Penn Central Company never got to the point of paying dividends. As far as the P.R.R. and later the P.C.T.C. was concerned, I think it is fair to state that all members of the Board recognized the intangible value of the long unbroken dividend record of the P.R.R. and that over a period of years it did add something to the way investment analysts regarded it from a quality standpoint. Therefore, there was a desire to maintain this unbroken record if feasible and in a number of years so-called token dividends of 25 cents per share were paid. The ultimate goal, I believe it is fair to say, was to set dividends, as far as possible, at a level that could be maintained on a regular basis year in and year out barring some catastrophe. The emphasis was on the regularity of dividends rather than the payment of extra dividends.

2. Q. Was this policy articulated in writing?

A. No, because the dividend policy was too flexible and involved too many factors which had to be considered. The answer to No. 1 is probably an over-simplification of the dividend policy for this reason.

3. Q. Did board members fully understand the dividend policy, particularly those members who were on the finance committee?

A. In my judgment, based on discussions both at finance committee and at board meetings, I believe the members were fully conversant and basically in agreement with the so-called dividend policy.

4. Q. How thorough and searching were finance committee decisions of quarterly dividend payments?

A. I cannot answer this question. It is a matter of opinion and degree and the number of questions and discussions varied from time to time.

5. Q. What dividend proposals were being discussed by the finance committee, were related matters discussed in detail—availability of cash? Debt maturity payments? Projected future earnings? Past earnings?

A. During the tenure of Stuart Saunders as chief executive officer, I presided at finance committee meetings, but generally at his request I would turn the meeting over to him to discuss the results of earnings, prospective earnings and various background material and then he would make the recommendation as to the dividend. The Treasurer's Report, which is part of the board docket, was presented monthly showing the cash and working capital position on various bases as shown below. From the time of the merger until the fall of 1969, accounting was under the jurisdiction of Mr. Perlman, but after accounting was placed under my supervision in the fall of 1969, certain formats were changed and more information was provided to the directors than previously. This is particularly true of certain subsidiary companies.

6. Q. Who usually proposed the amount of the dividend to the finance committee? Was there dissent? Frequently or infrequently?

A. During the regime of Mr. Saunders, almost invariably the dividend recommendation was made to the finance committee by him. As far as I can recall there were always questions and discussion, but I cannot remember any dissent by anyone to the action taken.

7. Q. Who usually proposed the amount of the dividend to the full board?

A. Almost invariably Mr. Saunders gave a resume of the current situation and prospective outlook, advised the board as to the recommendations of the finance committee and then requested approval by the full board.

8. Q. Were there any discussions about dividend recommendations by the full board? Was there dissent? Frequently or infrequently?

A. As was the case with the finance committee, there were frequent questions and discussions, but I can recall no dissent by anyone at the action taken. I was not a board member from Feb. 1, 1968 until the fall of 1969, but did attend most board meetings.

9. Q. In 1969 was there consideration given by either the finance committee or the full board to curtailment of the dividend payment prior to the fourth quarter? If yes, how thoroughly was this considered? Were cash figures available at these meetings?

A. There was considerable discussion at the finance committee meeting in June 1969 as to whether a declaration of dividend should be considered at that meeting or whether there should be a special meeting in July or August and it was finally decided that June was the customary time and that it should be decided then. I think it is fair to say that there was some hesitation as to just what action should be taken, but the recommendation of the Chairman was finally approved without dissent.

10. Q. Did the preponderance of bank interlocks affect dividend policy?

A. I never saw the slightest indication of any effect because of so-called bank interlocks.

11. Q. Did bank related directors press for high or continued dividend payments?

A. I do not think that being a director of a bank, at least as far as I could tell, ever came into consideration in the minds of the members of the board in the discussion of dividends.

12. Q. Were board and finance committee members fully aware of the critical cash position of the company in 1968 and 1969? If not, why was this information withheld? If yes, then who pressed to continue the dividends in spite of the poor cash position?

A. There was never really a time when the cash position of the railroad was not poor either before or after merger. It was always a matter of degree. As a matter of fact, having gone with the PRR in the spring of 1951, upon analysis I was so impressed with the poor working capital position, not only of the PRR, but of the entire industry that I arranged a so-called standby revolving credit agreements with our banks, the first company in the industry to do so in 1954. This action was taken in order to supplement our weak working capital position in the event of an emergency by having this credit to call upon. The cash position of the railroad was always available to the directors, it was pointed out that it was weak and as stated previously, it was always shown to the board on the Treasurer's Report each month. (A copy of February 1968 is attached as an example.)

13. Q. Were dividend declarations discussed with bank related directors prior to finance committee meetings or board meetings?

A. Naturally I have no way of knowing what discussions were carried on by either Mr. Saunders or Mr. Perlman, but I have no definite recollection of any real discussions held by me with any of the directors on this point except prior to the consideration of the fourth quarter dividend of 1969 and there is correspondence covering this.

14. Q. Did you feel that full and adequate information was presented to the board in regards to all matters brought before the board? Was ample time allowed for discussion and review? Were directors who dissented from the chairman's recommendations or viewpoint given the opportunity to fully present their dissenting viewpoint?

A. On a number of occasions I felt that certain presentations made were overly optimistic. However, I think there was an honest effort made by everybody concerned to allow sufficient time for discussion and review and on a number of occasions the method of reporting was changed in order to reduce the reporting of minor matters and allowing more discussion of the important subjects. In my opinion, all directors were given a full opportunity to express their opinions. After one presentation by myself, which was certainly not on the optomistic side with respect to the operation of the railroad, Mr. Perlman stated that he was not a harbinger of gloom like one or more of his associates and that he was looking ahead and not concerned about current results.

15. Q. Can you give us some background on John Seabrook's election to the board of directors of the New York Central Railroad? Do you know if his election was at the behest of Howard Butcher III of the investment firm of Butcher and Sherrerd?

A. I know nothing about the background concerning Mr. Seabrook's election to the board of New York Central.

16. Q. When Mr. Butcher resigned from the PCTC board in September 1968, was there any discussion as to removing Mr. Seabrook from the PCTC board also?

A. There was some discussion to this effect.

17. Q. Did Mr. Perlman press to have Mr. Seabrook resign? Did any other directors join Mr. Perlman's effort?

A. I do not recall which directors were involved. I know the question was raised, but I do not know whether anybody really pressed the matter or not.

18. Q. Did you consider that Mr. Butcher continued to have representation on the PCTC board through Mr. Seabrook?

A. No, Mr. Seabrook was an independent thinker.

19. Q. Were you told why you were excluded from the board of the merged company in 1968?

A. I was given no explanation, but since a very substantial number of my duties and responsibilities were taken away from me, it seemed all part and parcel of some action decided upon by Messrs. Saunders and Perlman.

20. Q. Can you tell us what the explanation was and by whom it was given?

A. In view of the answer to 19, this does not require an answer.

21. Q. Did you believe this explanation or did you feel there was some other reason for your exclusion?

A. In view of the answer to 19, this does not require an answer.

22. Q. Can you give us some background on your reappointment to the board in August 1969?

A. During the spring of 1969 on a number of occasions, Mr. Saunders pressed me to go back on the board of directors and on the Executive committee and I refused. I agreed to go back on the board in August 1969 when I had reluctantly under pressure agreed not to resign.

23. Q. Did you write a letter of resignation to Stuart Saunders in the summer of 1969? What was your reason for wanting to resign? Why did you not do so?

A. I wrote a very definitive letter of resignation to Stuart Saunders in June of 1969. The letter of resignation speaks for itself. A number of directors and Mr. Saunders pressed me not to resign and emphasized the harm it would do to the company if I took such action and insisted that I had a responsibility to the bankers lending us money, to our stockholders. I further discovered that despite my request to the contrary, the new President who agreed to come in, Mr. Paul Gorman, had not been advised of my decision to resign.

24. Q. In a letter dated 11/21/66, you attribute a policy of maximization of earnings to Mr. Saunders. Did you understand this policy to emanate from Mr. Saunders? Was it in writing? If not, in what manner was this policy circulated?

A. The fact that this was the accepted policy is well indicated by the fact that Mr. Saunders never contradicted my memorandum of 11/21/66 and it was impossible to attend budget or staff meetings for any discussion involving earnings without knowing what his clear policy was.

25. Q. We are aware of a considerable amount of correspondence from you, spanning a period of years, advising Mr. Saunders of the critical and difficult cash position of the railroad. Did you ever advise Mr. Saunders to abort the maximization policy and report earnings more in line with cash flow? In writing?

A. I had a number of verbal discussions with Mr. Saunders on the maximization of earnings policy and in writing pointed out on at least several occasions that our reported earnings and cash flow were getting further and further apart. However, Mr. Saunders as chief executive officer was within his rights to set the policy and it was my duty to conform as long as we stayed within the bounds of good accounting practice. While accounting was under my jurisdiction, no accounting action was ever taken with my knowledge that did not come within the bounds of sound accounting practice.

26. Q. Do you believe that the following are some illustrations of the implementation of this policy?

- (*a*) *Write off of passenger facilities and equipment?*
- (*b*) *Sale of Clearfield Bituminous Coal Co.?*
- (*c*) *Exchange of Madison Square Garden stock?*
- (*d*) *Use of the merger reserve?*
- (*e*) *Capitalization of New Haven car repairs?*
- (*f*) *New York Central Transport dividends?*
- (*g*) *Washington Terminal dividends?*
- (*h*) *Strick Holding Co. dividend?*
- (*i*) *Others?*

A. (a) I think that the write off of passenger facilities was a realistic and sound move somewhat similar to that recently taken by RCA in writing off huge amounts in connection with its data processing business. No one can deny at the same time that in future years earnings would be helped by the reduction in depreciation charges, but the actual write off was made very clear to both stockholders and the public.

(b) This was done primarily for the purpose of making it possible through proper corporate procedure to transfer cash from Pennsylvania Co. to PRR. It is true that it had the effect of increasing the earnings of the railroad, but it had no effect on a consolidated basis.

(c) We exchanged a 25% interest in Madison Square Garden, Inc. which was a non-marketable stock and a 55% equity interest in an office building for Madison Square Garden stock which gave us a participation in the whole project and, most important, *a marketable security. This was the primary purpose.* Here again, it is true that it increased the earnings of the owning company, but had no effect on the consolidated statement.

(d) I think the establishment of a major reserve was sound and proper because it was in no way hidden from either the stockholders or the public. It also meant that we could compare earnings or losses before and after the merger on a comparable basis not obscured by non-reoccurring items. I do think that undue pressure was exerted from time to time to charge items to the reserve which did not belong there.

(e) I am not familiar enough with this to comment.

(f) I was not a member of the board of New York Central Transport and was not consulted about this transaction. I was told it was done to minimize taxes, but it is true that it improved the earnings of the railroad but had no effect on the consolidated earnings.

(g) I think this transaction was handled properly accountingwise except as to whether or not it was ordinary or extraordinary income and I did not participate in the latter discussions.

(h) I do not recall what was involved in the Strick Holding Co. dividend, and to the best of my recollection I was not involved in this.

27. Q. To your knowledge, was the board of directors aware of the policy of maximization of earnings; if not do you think they should have been?

A. It is my judgment that the directors were aware of the policy of maximization of earnings within the bounds of good accounting practices which were being employed.

28. Q. Did PMM ever take a diverse viewpoint to that of the railroad in any of the transactions resulting in maximization of earnings? How were the differences resolved?

A. On some occasions when questions were raised with PMM they decided against the railroad, but I of course did not participate in all discussions. When accounting was under my jurisdiction before the merger and again starting in the fall of 1969, when any real question arose we would sit down and discuss the matter with Peat, Marwick & Mitchell and accept their conclusions as to what was proper accounting practice and always followed their recommendations.

29. Q. Were you a member of the budget committee? Did you attend budget meetings? Were the monthly or periodic meetings concerned with ways and means of maximizing earnings? Who chaired the meetings? Were minutes of the meetings maintained by a secretary or someone appointed to act in that capacity? Did you keep notes of these meetings? If so are they available?

A. Yes. Meetings prior to merger were more truly budget meetings in my opinion than after merger primarily because after merger we operated with estimates month by month for two or three months ahead rather than through carefully prepared income budgets because Mr. Perlman claimed that it was not practical to make true income budgets for a railroad. However, maximization of earnings was involved in discussions almost inevitably at most of the meetings. Mr. Saunders. I do not recall. No. Not necessary to answer in view of previous answers.

30. Q. Was Alfred E. Perlman aware of the policy of maximization of earnings?

A. Yes. It was impossible for anyone from the level of upper middle management to the top not to be aware of the policy of maximization of earnings.

31. Q. From the date of merger (2/1/68) until shortly before Mr. Perlman became vice-chairman (12/1/69), Mr. Perlman was in charge of the accounting function of the railroad. Was there any doubt in anybody's mind that Mr. Perlman, was, in fact, in charge of the accounting functions?

A. There is no doubt in my mind and I never heard any doubt expressed by anyone.

32. Q. Are you aware of any effort on anyone's part to withhold accounting or financial information from Mr. Perlman?

A. I am not only not aware of anyone withholding accounting information from Mr. Perlman, and I believe it would have been impossible. After all Mr. Perlman was the President. In addition, Mr. Cook, who was Vice President of Accounting reported to Mr. Walter Grant, who was Executive Vice President and formerly with the New York Central and he in turn reported to Mr. Perlman. Mr. Perlman received the same information that all board members received and he received all information received by members of the Executive Committee, the Finance Committee and the Budget Committee. As far as financial information is concerned, I personally never refused any financial information to Mr. Perlman. nor to the best of my knowledge did anybody in my department do so.

33. Q. Did you hear or become aware of an incident at one of Mr. Perlman's staff meetings where Mr. Perlman asked Mr. Hill (Controller) for certain figures and was denied such figures by the response, "I am proscribed from giving you those figures?"

A. I have no knowledge with respect to this situation. I did not attend Mr. Perlman's staff meetings.

34. Q. To your knowledge, were major GSC/Macco sales, and the accounting therefor, approved in advance by PCTC officers? If so can you identify such officers?

A. Sales over a certain amount were approved by the Board of Directors of Great Southwest and Macco. With respect to accounting, after merger, accounting came under the jurisdiction of Mr. Perlman until the fall of 1969 when, as stated before, it was returned to me. Before the end of 1969, at my request, Mr. Hill and perhaps one or two others went to the west coast to review major transactions with the staff of Great Southwest and with Peat, Marwick & Mitchell.

35. To your knowledge, were detailed GSC/Macco income forecasts or budgets presented to the railroad or Pennsylvania Company'? Did the forecasts project earnings by project?

A. Yes, the forecasts did not however contain breakdowns by individual projects.

36. Q. Were you aware of pressure brought to bear on GSC/Macco officers to maximize earnings? How was this pressure brought to bear? By whom?

A. As far as I was concerned I always advised them that our policy was to earn as much money as possible, but no improper accounting should be involved, nor should any sales be made hastily at a sacrifice in order to increase earnings. Mr. Saunders frequently called the top officers of various subsidiaries directly in regard to earnings and although I was not a part of these conversations, my impression was that pressure was applied.

In the last report by the ICC, there were a number of statements critical in nature that we consider unjustified, but since they have been answered elsewhere it would be repetitious to do so again here, except for the matter of investments. In various places it has been alleged that the investment of the pension fund was completely under the control and domination of Robert Haslett, Investment Vice President, myself and Mr. Hodge of the firm of Glore Forgan. Mr. Hodge has also been characterized as Chief investment adviser of the pension fund. Actually, neither Mr. Hodge nor his firm ever had any connection whatsoever as investment adviser to the fund. Since its inception, Drexel & Co., up until quite recently, was the one and only investment adviser to the pension fund.

Further, the operation of the pension fund has always been under the direct supervision of the Pension Committee of the Board of Directors and every purchase and sale was reported and approved by them quarterly. Actually, the operation of this pension fund under the supervision of Mr. Haslett and myself was one of the most successful of any pension fund in the country. Attached hereto is a report made by me to the Board of Directors covering the operation of the pension fund from the time it came under my supervision through the close of 1968 and this record speaks for itself.

MEMORANDUM

APRIL 21, 1969.

This memorandum contains the highlights of the administration of our Pension Fund since I became Chairman of the Managers of Pensions eighteen years ago. Attached is certain backup information which gives additional details in connection with the operation of the Fund.

At the end of 1950, the Fund at cost totalled $22,359,000 and the market totalled $22,001,000, slightly less. Approximately 97% was invested in fixed income securities, preferred stocks and bonds, and 3% in common stocks. At the end of 1968, on a cost basis the Fund aggregated $268,000,000 and on a market basis $376,000,000. On a cost basis, approximately one-half was invested in bonds and preferred stocks, and one-half in common stocks. On a market basis 34% was invested in bonds and preferred stocks and 66% in common stocks.

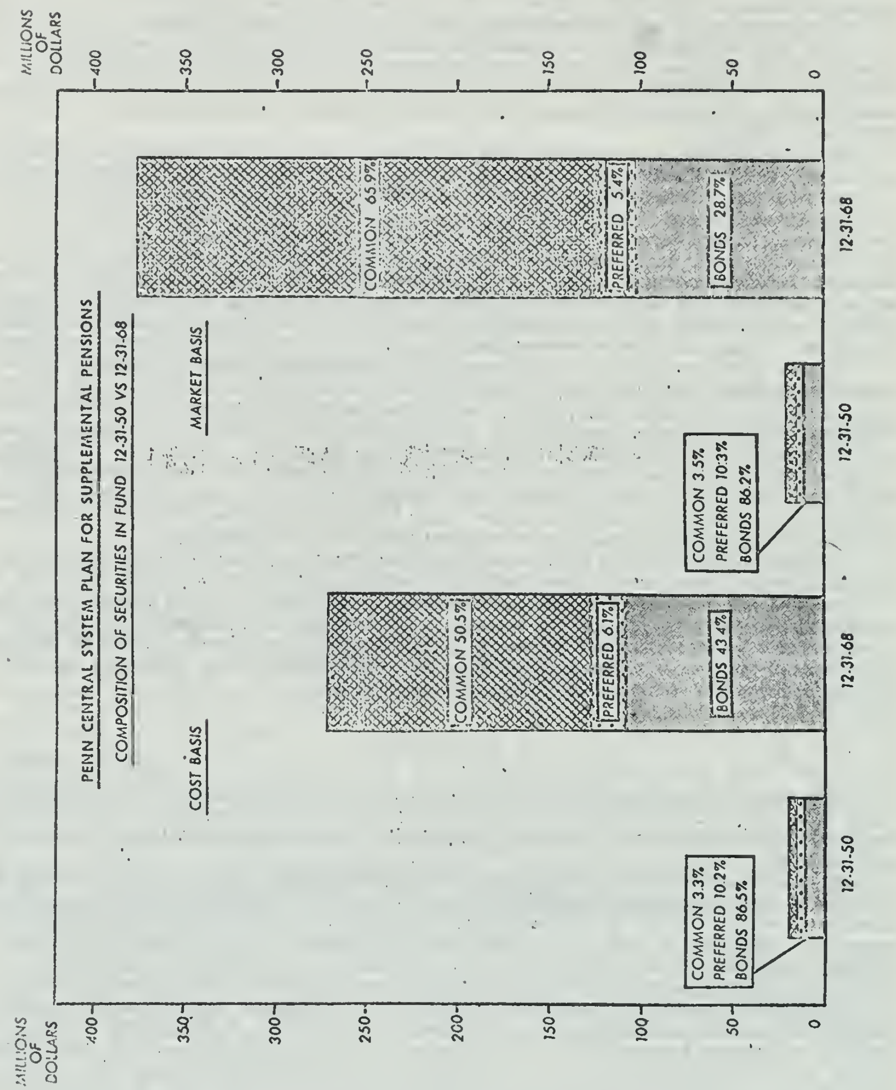
During this period the unfunded liability of the Pension Fund reached a peak of $96,462,000 in 1956, as contrasted to total assets in the Fund of $68,173,000 at that time. Since then increased benefits built into the plan to make it competitive with other Pension Funds have added estimated actuarial liabilities of $53,400,000. Despite this, at the end of 1968, on an estimated basis, there was an over-funding of the plan on a market basis of $8,200,000 or a net overall improvement in the unfunded liability of $158,000,000.

Charges to operating expenses for current and past service on an actuarial basis reached a peak in 1958 of $9,700,000 and have been reduced to an all time low of $1,147,000 last year. It should be noted that the last figure is for the combined Penn Central Railroad as contrasted to $9,700,000 in 1958, a charge solely against the Pennsylvania Railroad.

Finally, as of December 31, 1950, on a cost basis 32% of the Fund was invested in Pennsylvania Railroad or affiliated company securities and, as of February 28, 1969, on the same basis, ownership in company and affiliated securities had been reduced to 7%.

DAVID C. BEVAN.

[EXHIBIT I]



PENN CENTRAL SYSTEM PLAN FOR SUPPLEMENTAL PENSION PLAN

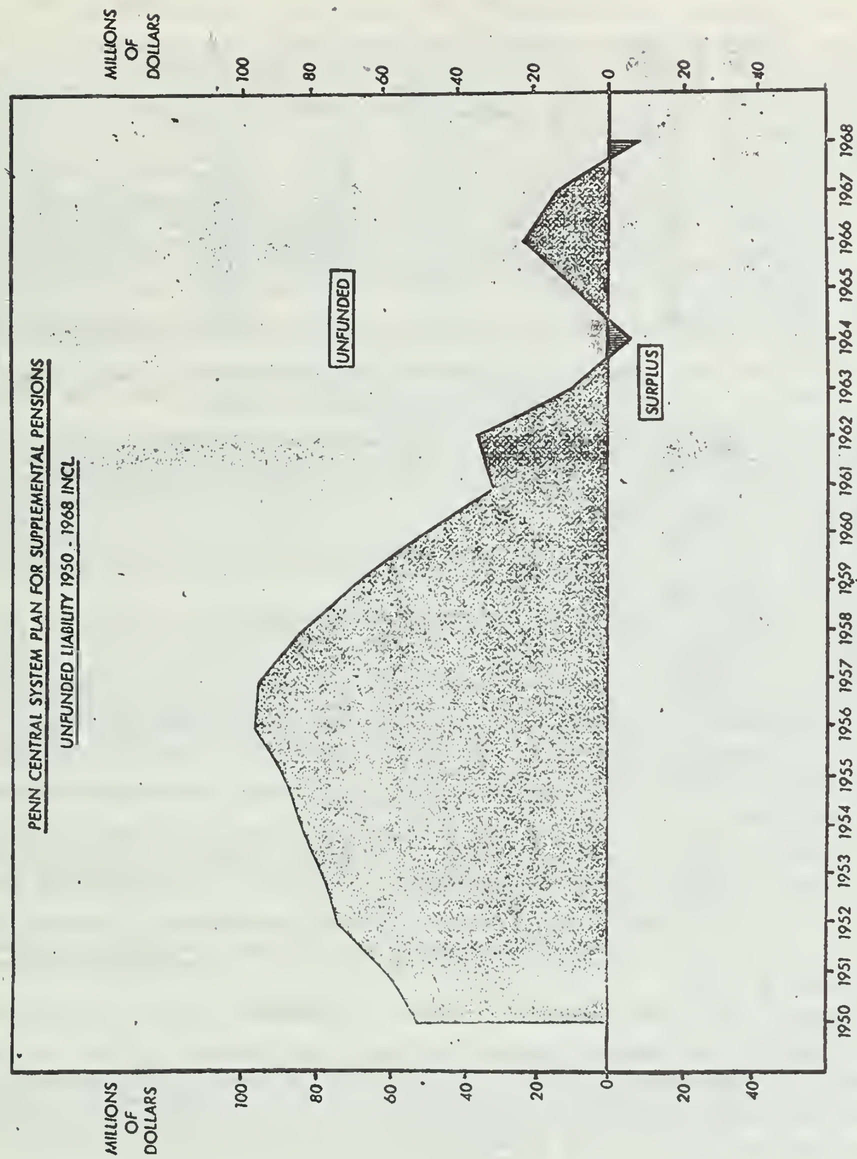
COMPOSITION OF SECURITIES IN FUND—MARKET BASIS (1950–68, INCLUSIVE)

[In thousands of dollars]

	Bonds	Preferred stock	Common stock	Total
Dec. 31:				
1950	18, 961	2, 265	775	22, 001
1951	19, 715	2, 878	3, 618	26, 211
1952	24, 249	4, 670	5, 723	34, 642
1953	29, 505	6, 497	6, 213	42, 215
1954	31, 622	9, 714	12, 734	54, 070
1955	34, 404	8, 752	20, 091	63, 247
1956	38, 423	7, 736	23, 393	69, 552
1957	45, 632	8, 169	23, 840	77, 641
1958	51, 833	8, 287	38, 239	98, 359
1959	60, 913	9, 267	51, 753	121, 933
1960	72, 919	9, 309	60, 708	142, 936
1961	73, 474	10, 520	85, 663	169, 657
1962	75, 323	11, 107	83, 284	169, 714
1963	84, 528	9, 200	100, 707	194, 435
1964	83, 704	7, 134	115, 030	205, 868
1965	80, 707	5, 530	136, 051	222, 288
1966	81, 195	4, 205	115, 964	201, 364
1967	77, 567	9, 937	127, 934	[1] 215, 438
1968 [2]	107, 999	20, 188	247, 723	375, 910

[1] Excludes Long Island RR. a/c withdrew from joint administration Sept. 30, 1967—$12,824,098.
[2] Includes former New York Central funded plan assets.

[EXHIBIT II]



PENN CENTRAL SYSTEM PLAN FOR SUPPLEMENTAL PENSIONS—UNFUNDED LIABILITY

[1950 to 1968, inclusive, in thousands of dollars]

Dec. 31	All companies	Dec. 31	All companies
1950	$51,722	1960	52,505
1951	60,020	1961	30,752
1952	74,578	1962	35,561
1953	77,541	1963	9,052
1954	81,617	1964	(7,346)
1955	85,738	1965	7,316
1956	96,462	1966	22,234
1957	95,189	1967	14,746
1958	82,969	1968	(8,181)
1959	68,169		

Estimated. Includes former New York Central Funded Plan.

Note: Figures in parentheses denote surplus.

[EXHIBIT III]

AMENDMENTS TO SUPPLEMENTAL PENSION PLAN, MAY 1, 1951 TO APRIL 1, 1969

July 1, 1954.—Compulsory retirement for officers scaled down to age 65 by 7–1–58 adopted; Optional retirement on scaled down ages also provided; plan amended to correlate with Railroad Retirement base increase from $300 to $350, and a 12 month withdrawal period approved ending 12–3–55 for members whose average compensation dropped below 350. *Estimated Cost—$1,500,000.*

January 1, 1955.—Prior service credits eliminated for employees becoming members of the plan on and after 1–1–55; eliminated credit for future *non-contributory* service; established after retirement options (100%–75%–50%–25%); established vesting provision for members leaving service after completing 120 months of contributory membership and either attaining age 55 *or* having 240 months of compensated service; contributions and service credits eliminated for members over age 70. *Estimated Saving—$20,100,000.*

January 1, 1958.—Vesting at age 60 permitted if member had 30 years of service. *Estimated Cost—Minimal.*

January 1, 1959.—Contributions and service credits restricted to age 65. *Estimated Cost—None.*

June 1, 1959.—Plan amended to correlate with Railroad Retirement base increase from $350 to $400, and a 12 month withdrawal period approved ending 6–30–60 for members whose average monthly compensation was below $400.

January 1, 1961.—Membership closed to agreement employees hired on and after 1–1–61; new membership permitted on a calendar year basis—January 1st only; provision made for widow's pension of 25% or 50% in event of member's death between ages 60–65; provision made to permit withdrawal with refund of contributions and interest at any time. *Estimated Saving—$40,500,000.*

October 1, 1961.—Established retirement for members with less than 30 years of service between ages 62–65 on a reduced basis, to correspond with similar change in Railroad Retirement Act also effective 10–1–61.

June 1, 1962.—Continuance of service beyond age 65 authorized with approval of Board of Directors, but no additional service or earnings credits permitted. *Estimated Cost—None.*

December 19, 1962.—Occupational disability approved—under 65, with 30 years of service no reduction; with less than 30 years of service credit is given for 30 years and reduction of 1/180th for each month under 30 years applied to pension. Authorized Managers of Pensions to change or cancel member's survivorship option prior to age 63. Various other technical amendments. *Estimated Cost—Minimal.*

November 1, 1963.—Plan amended to correlate with Railroad Retirement base increase from $400 to $450.

February 1, 1965.—For non-agreement employes, plan made non-contributory and pension formula changed to 1¼% credit for each year of service, times average earnings during final five years, less 80% of Railroad Retirement annuity payable (using $400 RRA base). *Estimated Cost—$33,700,000.*

July 1, 1965.—Provision made for election of widow's survivorship option which could become effective prior to retirement from age 55 instead of age 60 and the period during which proof of health is required reduced to six months prior to effective date of option. *Estimated Cost—None.*

January 1, 1966.—Plan amended to correlate with Railroad Retirement base increase from $450 to $550.

November 1, 1967.—For non-agreement employes only, provision made for retirement at age 62 or over regardless of service, or between 60 and 62 with 30 years of service, without reduction; between ages 60 and 62 with less than 30 years of service pension is reduced 1/180th for each month under age 62. Non-agreement employes creditable service percentage factor raised from 1¼% to 1½%. Pensions of non-agreement members retired before 11–1–67 increased by 10%. *Estimated Cost—$22,000,000.*

January 1, 1968.—Plan amended to correlate with Railroad Retirement base increase from $550 to $650.

February 1, 1968.—Plan revised to pick up New York Central Funded Contributory Retirement Plan members; all non-agreement employes of merged company made members of plan, even though they had previously declined, failed to subscribe, or withdrawn, with service creditable only from 2–1–65 (PRR members) or 3–1–65 (NYC members). Disability computation no longer subject to reduction. *Estimated cost $7,200,000.*

* * * EDUCATIONAL INSTITUTION AND COMMON TRUST FUNDS IN PHILADELPHIA AND NEW YORK BANKS

	Supplemental pension plan	Indexes					
		June 30 (A)	July 31 (B)	Oct. 31 (C)	Nov. 30 (D)	Oct. 31 (E)	(F)
Aug. 31, 1956	100	100	100	100	100	100	100
Aug. 31, 1957	97	94	95	93	96	93	97
Aug. 31, 1958	105	98	99	108	113	108	100
Aug. 31, 1959	117	99	114	114	116	113	114
Aug. 31, 1960	121	99	111	113	115	114	113
Aug. 31, 1961	139	104	128	133	137	138	125
June 30, 1962	129	103	118	121	130	116	121
June 30, 1963	153	115	132	138	139	139	132
June 30, 1964	170	118	145	150	150	155	142
June 30, 1965	181	120	145	154	152	167	145
June 30, 1966	189	110	135	137	137	146	138
June 30, 1967	208	110	144	139	138	175	143
June 30, 1968	231	106	148	152	165	182	150

PENNSYLVANIA NEW YORK CENTRAL TRANSPORTATION CO.

REPORT OF TREASURER, PERIOD FEB. 1–20, 1968, INCLUSIVE

	Feb. 20, 1968	Jan. 20, 1968	Feb. 20, 1967
Working cash position:			
Gross cash	$59,209,266	D $29,489,552	D $56,090,878
Less outstanding paychecks, vouchers, dividend checks, etc	33,938,425	I 4,078,051	D 2,599,512
Net working cash	25,270,841	D 33,567,603	D 53,491,066
	Net working cash	Working capital	Working capital less materials and supplies
Dec. 31, 1966	$93,641,034	$22,583,315	[1] $67,968,128
Dec. 31, 1967	55,171,955	[1] 8,606,051	[1] 100,208,772
Jan. 31, 1968	46,517,847	[2] 26,279,095	[2] 121,342,095

[1] Deficit.
[2] Estimated deficit.

EXHIBIT 54

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In the Matter of	:	In Proceedings for the
	:	Reorganization of a
PENN CENTRAL TRANSPORTATION	:	Railroad
COMPANY,	:	
Debtor	:	No. 70–347

REPORT OF TRUSTEES ON REORGANIZATION PLANNING FEBRUARY 15, 1972

The Court on November 3, 1971, extended the time within which to file a plan of reorganization to April 1, 1972, and instructed the Trustees to file by February 15, 1972, a report on the prospects for reorganization of the Debtor (Order No. 475). This is that report.

SUMMARY

The basic question put to the Trustees by the Court is whether, in their judgment, a successful reorganization of Penn Central* is probably feasible.

The short but carefully considered answer to this question is that in the Trustees' judgment Penn Central *can be* successfully reorganized.

The rest of the answer is that this conclusion is based on and depends on two elements which must be made unequivocally clear. One is the attainment of the projections which have now been made regarding the volume of traffic and freight revenues which can be reasonably forecast for Penn Central during the next five years — taking account of (i) prospective general business conditions, and (ii) Penn Central's ability to advance in the highly competitive transportation market. The other is the accomplishment of three basic changes in the Penn Central situation which will require action beyond the sole competence of the management, the Trustees, or this Court: rationalization of the Penn Central plant, removal of unnecessary labor costs, and full compensation for continuing passenger service losses.

Since the prospects of a successful reorganization depend on making these three clearly basic changes, a serious time factor is involved here. The changes require the concurrence in one form or another of various interests, government and private. The benefits of some of the changes will by nature of the circumstances be postponed, in part, even after the arrangements are completed and authorized. And additional obligations (for currently deferred taxes, interest charges, and other claims) are being incurred by the Debtor at the rate of approximately $100 million each year. This means an accumulation of prior charges against the estate before values available for pre-bankruptcy interests.

The Trustees' conclusion regarding the prospects for reorganization gives full account to these time factors. We believe that there is reasonable prospect that the three changes can be accomplished in substantial part during 1972 and 1973, and that virtually full benefit from the changes can be realized by the end of 1975. Accomplishment this

*As used in this Report, the term "Penn Central" refers to the Debtor in reorganization: Penn Central Transportation Company.

year or next would enable the Trustees promptly to begin at least partial payment of obligations now deferred (*e.g.,* current state and local taxes).

On these assumptions, the Trustees now conclude that Penn Central may be expected (i) to begin generating substantial income available for fixed charges in 1974, and (ii) to show, by 1976, income available for fixed charges of between $220 million and $290 million. This provides, in the Trustees' judgment, a basis for reorganizing the Debtor and for preparing their plan of reorganization.*

If these three changes were not to be made — or if there were undue delay in making them — there would not be, in the judgment of the Trustees, the basis for reorganizing the Penn Central as a private enterprise. This conclusion is based on studies and analyses which show that *maximally effective self-help measures alone* — taken with the most reliable available estimates of traffic increases in the future — would result in continued losses during the next four years and would show only marginal earnings by 1976. That would be too little and too late — for there would have been unconscionable and possibly unconstitutional erosion of the Debtor's estate in the meantime. This judgment could only be invalidated by an unlikely confluence of favorable developments including a spectacular and sustained increase in revenues far beyond what is here forecast.

The prospect of reorganization therefore hinges on achieving, in significant degree, the three changes which have been identified as requiring the participation and cooperation of interests other than the Penn Central management, the Trustees, or the Court, as well as, of course, the utmost efforts on the part of the management and the Trustees.

1. The proposed *rationalization of the Penn Central plant* involves (i) taking advantage of the potential for increased efficiency made possible in theory by the 1968 merger but never realized in fact, (ii) abandonment of those freight lines which have neither business nor public service justification, and (iii) making appropriate arrangements for continuing those freight lines found to be essential to the public service but inoperable on a sound business basis.

The Penn Central system presently covers approximately 20,000 route miles.

Approximately 80% of Penn Central's freight business comes from 11,000 of those route miles. This is graphic reflection of the fact that the Penn Central system has the lowest freight revenue per mile of line of any major railroad in the East.

Thus, 11,000 miles have been taken, for purposes of this reorganization feasibility determination only, as a "core" system — with full recognition that this alone would *not* constitute a full-service system, taking all interests into account. Similar analyses are being made of larger "core" systems.

With respect to the remaining 9,000 route miles, virtually all shippers have abandoned well over a third of them. This should be recognized by appropriate abandonment certificates from the Interstate Commerce Commission, and its newly revised procedures should expedite this result.

The remaining route miles which still serve a useful purpose can continue to be operated — some of them, hopefully, by a revitalized Penn Central itself, some with help from those interests, either public or private, which are prepared to underwrite the losses. A particular branch line may be of sufficient importance to the shippers or communities it serves that contracts assuring continued service at a price that makes Penn Central whole can be negotiated. Under these circumstances, the Trustees would not be compelled to seek abandonment of any mileage which serves a substantially useful purpose.

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*As used in this Report, "income available for fixed charges" is calculated after deduction of equipment lease rentals.

No simple or single quantification of the benefits of the rationalization we propose is possible — there are too many variables.

2. The proposal with respect to *personnel reductions* is that only those train and engine service employees determined to be necessary to safe and efficient freight operation be employed.

Collective bargaining on this issue is now in progress. If it fails, as it has in the past, the Trustees will accept — as has already been indicated to the National Mediation Board — an independent third-party determination of the issue.

The issue here is whether approximately 9,800 employees presently required to be employed by prior labor agreements (and by "full-crew" laws) are necessary for safe and efficient operation.

The cost involved here, at 1972 levels, approximates $150 million per year.

The Trustees propose that the reductions in question will be gradual and that protection will be afforded present employees.

3. The proposed change in *compensation for providing passenger service* is that Penn Central be fully reimbursed for the costs of providing that service. The reorganization of Penn Central can and should provide whatever passenger service is necessary in the public interest. At the same time, the burden which that service imposes on the system should be eliminated as present arrangements are renegotiated or new ones entered into. Present arrangements with Amtrak fall far short of enabling Penn Central to recover its current costs, even aside from any return on its investment. It should be recognized, for example, that passenger service as a whole in the Washington-New York-Boston corridor is not provided as a by-product of freight service but is, rather, the principal service and should be paid for accordingly. Even greater losses are being sustained in commuter service.

The reimbursement factor involved here amounts to $87.2 million on a 1972 basis (exclusive of return on investment).

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The Trustees fully appreciate the significance of these three proposed changes. They are commended by the dictates of that fairness and equity which must characterize any plan of reorganization. Major progress in these areas, along with increased business volume, means the difference between viability and non-viability, between feasibility and non-feasibility of a successful reorganization.

So far as the more immediate cash flow prospects are concerned, the Trustees believe that Penn Central will remain from here on — barring unforeseeable adverse developments — in a position to continue operations, but only on a bankruptcy basis. The timing of its ability to do better, and to meet presently deferred obligations such as taxes, will depend on the promptness with which the three essential changes described above are made.

The remainder of this Report details what is summarized here and considers additional matters identified in Order No. 475, including the alternatives to reorganization.

The question of alternatives warrants particular notice, and it has played a significant role in the Trustees' consideration of this matter. The Trustees oppose the alternative of nationalization. The bill for it would be billions of dollars. It would embalm present inefficiencies and inadequacies which the Trustees' proposals would correct. We have developed an alternative to nationalization which requires simply tough, spartan, private self-discipline, and the cooperation of those public and private agencies and groups whose interests are involved here. Nationalization would be a sorry, needless price to pay for lack of the exercise of common, ordinary good sense and responsibility.

I. PROGRESS IN ELIMINATING OBSTACLES TO THE VIABILITY OF THE DEBTOR

Penn Central's problems lie in two areas. Some obstacles to a successful enterprise are within management's competence to overcome. But there are certain conditions with regard to which self-help — in the present context, by management, the Trustees, and the Court — can be effective to only a limited degree because of constraints imposed by law, regulation, or other external factors.

A. Management Accomplishments

Where obstacles to viability can be overcome by better management, progress has been substantial.

Stricter internal controls have enabled the Trustees to curtail the rate of cash attrition which they encountered at the beginning of their stewardship. The Court, acting under the Bankruptcy Act, has permitted the deferral of both post- and pre-bankruptcy expenses which could not have been met out of operating revenues.

Tighter controls have brought the railroad's operating ratio (percentage of operating revenues consumed by operating expenses) for the first 11 months of 1971 down to 88.32%, compared with 92.11% for the same period in 1970.

Employment, which was 90,319 in January 1971, was reduced to 83,322 by January 1972, or by 7.7%.

Equipment utilization has been substantially improved. The railroad is making more use of its own cars and correspondingly less use of foreign line equipment, and is handling more net ton miles per average car day on line. Faster turnaround for repair work has sharply increased locomotive availability.

All this, plus equipment acquisition and improvement of roadway and facilities, now gives the railroad the capacity to solicit and handle an increased volume of traffic. Further details are set out in "A Report on 1971," issued on December 22, 1971 by Mr. William Moore, president of Penn Central, a copy of which is attached hereto as Exhibit A.

This is not to suggest that we have any feeling of complacency, or that the possibilities for progress have been exhausted.

Railroads, and Penn Central in particular, have lost much ground which can and should be recovered. Of the total ton miles of freight in the United States, the share carried by railroads declined from 62.0% immediately prior to World War II to approximately 40% in 1970. The eastern railroads' share of the total United States rail revenue ton miles declined from 38.6% in 1958 to 33.3% in 1970. Penn Central (that is, the three systems which preceded it) had 34.9% of the ton miles carried by eastern railroads in 1958, but only 33.0% in 1970. Between 1966 and 1970, *originating* tonnage on the Penn Central *fell* by 14.8%, while on other eastern railroads it decreased by only 0.6%; on southern and western lines it *rose* by 12.0% and 4.6% respectively.

While Penn Central's tonnage decreased from 282 million in 1970 to approximately 261 million in 1971, freight operating revenues increased from $1,392 million to approximately $1,535 million.

The competitive picture is starting to change. Penn Central handled 34.8% of the net ton miles of rail traffic in the eastern district during the first nine months of 1971, compared with 32.9% during the same period in 1970.

Penn Central is now making important exceptions to across-the-board freight rate increases. Moreover, it is reducing rates selectively whenever the evidence indicates that this will result in greater contribution to earnings by attracting more volume. At the same time, it has not hesitated to file increases in those instances in which rates are below costs.

Penn Central is becoming a more effective competitor. Divergence of views regarding piggyback service on the part of the former New York Central, Pennsylvania, and New Haven, and unfulfilled commitments after the merger — along with increases in

74-924 O - 73 - 42

piggyback rates almost twice as great as increases in truck rates — resulted in a post-merger drop in Penn Central piggyback business from 520,000 trailers in 1968 to 420,000 trailers in 1971. In the last half of 1971, when Penn Central's new services and reduced rates began to take effect, that trend was reversed. It could be reversed faster if transportation costs could be cut by 10 to 15 percent by using three-man train and engine crews.

The Trustees have moved vigorously to achieve the objective of divesting the estate of non-rail assets without sacrificing maximum realization of values. Principal efforts are reflected in proposals, to be brought before the Court, for the sale of certain Park Avenue properties and the transfer of the Trustees' stock in Pennsylvania Company. Other major real estate sales have been made, although, because of encumbrances, there has not been material progress thus far in making the proceeds of sales available for capital expenditures.

B. External Constraints

Given the volume of traffic which can reasonably be projected for Penn Central over the next five years, as explained below, the principal obstacles to viability involve elements beyond the exclusive control of management and the Trustees. While self-help is required in these areas as well, outside cooperation and assistance is necessary to achieve (1) changes regarding the physical plant, (2) the complete elimination of redundant labor, and (3) full reimbursement for the costs of furnishing passenger service.

There has been some, although relatively little, progress regarding these obstacles. A good deal has been done about each of them, but the results as of now fall far short of the goals. Most progress has been procedural.

1. *Plant Rationalization.* So far as restructuring Penn Central's plant is concerned, applications have been filed, since January 1, 1971, to abandon 995.7 route miles, and approvals covering 350.9 miles have been received. Filing of applications to abandon an additional 829.2 miles has been approved by the Trustees.

This piece-meal approach obviously is not the answer. Even the new and welcome streamlined Interstate Commerce Commission procedures are not enough to fully achieve the plant rationalization which is a necessary part of a Penn Central reorganization.

2. *Surplus Personnel.* So far as concerns Penn Central's redundant manpower situation, the Trustees' report of August 31, 1971 covers most of what has taken place — and has not taken place.

Negotiations at the national level regarding the fireman manning issue have not been active. The procedures of the Railway Labor Act have been exhausted, and either party is free to resort to self-help measures.

The critical train crew consist negotiations are proceeding under the rules of the Railway Labor Act and have been carried forward diligently. The National Mediation Board has now, as the last step in the mediation process, urged both parties to submit the dispute to binding arbitration. Penn Central has agreed to do so. The United Transportation Union has not yet responded. We mark time — at an estimated unnecessary cost of almost a half million dollars a day.

Agreement has been reached with the United Transportation Union and the Brotherhood of Locomotive Engineers to change several outdated work rules regarding interdivisional assignments, the elimination of radio arbitraries as such, and a liberalization of road-yard, switching limits and interchange rules. The contract with the Union has been signed (on January 27, 1972), and the Trustees have been authorized by the Court to implement these work rule changes. The ultimate annual savings that will result from these changes will be approximately $15 million. Full realization of the benefits will be achieved in progressive stages.

Under the several 1971—1972 labor contracts, most of the other work rules in dispute are referred to various labor-management Standing Committees. In general, there has been little progress through the Standing Committees procedure.

The New York "full-crew" law has been repealed. The Ohio legislature is considering repeal, but there can be no further action now until it reconvenes on March 8, 1972. In Indiana, the legislature amended the full-crew law on February 9, 1972, in a manner which would materially improve the situation in that State.

3. *Passenger Losses.* There has been *partial* progress regarding the passenger service drain on Penn Central's resources.

The Amtrak contract of April 1971 provides for reimbursement of expenses which are "solely for the benefit of Intercity Rail Passenger Service...plus all other costs reasonably and necessarily incurred in connection therewith...which are shown...to be avoidable costs" (Sec. 5.1). The Trustees accepted this formula as an interim measure pending establishment of a long-run basis for continuing inter-city service. Under this contract, Penn Central is currently receiving, in addition to reimbursable expenses which are "solely for the benefit" of intercity passenger operations, $7.9 million annually as supplemental payments. The Trustees cannot accept these supplemental payments as an equitable measure even of "avoidable costs" — that is, costs which could be eliminated if the service were terminated. Preliminary studies of avoidable maintenance-of-way costs in the Boston-Washington corridor are now being reviewed by Amtrak. The contract provides for arbitration if agreement cannot be reached. But, in any event, it should be noted here that, as discussed below, "avoidable costs" are not an appropriate basis for compensation in the case of Penn Central.

Penn Central also continues to sustain heavy losses in commuter service. Even where some reimbursement is being received, it does not in most areas cover the full costs of operating the service, much less a return on investment. The Trustees are aggressively attempting to cure this situation.

4. *Other external constraints.* Penn Central's competitive position could be further improved if it had more freedom to control its own rates. Managerial initiative and judgment, within reasonable limits, no longer need to be frustrated by a regulatory scheme adopted in an era of monopoly, which has now been replaced by vigorous intermodal competition. Canada, Great Britain, and most of Europe now permit contract rates in varying forms, in return for shipper commitments to use rail services. United States railroads should be free to enter into similar arrangements.

Divisions of rates for traffic moving between the East and points in the South and certain areas of the West are disproportionate to the service rendered by the Eastern lines, at a cost to Penn Central of tens of millions of dollars annually. The Trustees have proposed an amendment to Section 15(6) of the Interstate Commerce Act — not to change the present standards for fixing divisions, but rather to provide a faster procedure for resolving divisions disputes on their merits.

With respect to taxes, the Trustees note that railroads generally bear an unreasonable burden of property taxes, impairing their ability to compete for freight traffic now moving on the highways. The practice in most States of taxing railroad property as though it could be sold for other use costs Penn Central many millions each year. Moreover, railroad rights of way are generally taxed while those of the trucks and barges are not.

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In short, there has been progress — real progress — in areas within management's control. Penn Central "made do" in cash flow terms to such an extent in 1971 that not going back to the Congress for more money — as had been expected — was one of the significant, unnoticed "non-events" of the year.

There are critical areas which require the cooperation and assistance of others.

Nevertheless, the progress management has made is the basis for combining our response to the Court's question about the future viability of the Debtor with our advice

regarding the probable feasibility of reorganization to which we now turn. We understand the term viability, and use it in this Report, as referring to an economically successful railroad enterprise which generates enough earnings to provide for a reasonable level of fixed charges, to permit reinvestment as necessary in rolling stock and fixed plant, to provide a reasonable rate of return for an equity interest, and by virtue of all that to attract new capital as necessary.

We find no obstacles to viability in those terms, or to a feasible plan of reorganization, which appear to us insurmountable.

II. THE PROBABLE FEASIBILITY OF SUCCESSFUL REORGANIZATION

The probable feasibility of successful reorganization — or the creation of a viable railroad enterprise — necessarily involves two questions. The first is whether a plan can be devised which will, when consummated, result in a viable railroad company; the second is whether, assuming such a plan, it can be consummated within a reasonable period of time — that is, soon enough so that continued operations before consummation do not so erode the Debtor's estate as to be either practically or constitutionally impermissible. It is not enough simply to see light at the end of the tunnel; the length of the tunnel is also critically important.

A. Can a successful reorganization plan be devised?

The Trustee's answer is Yes.

Two possible sets of assumptions must be dealt with here.

1. It would be one matter whether, *assuming maximum self-help efforts alone, and without the cooperation of others in removing or reducing external constraints,* the railroad would become viable in a reasonable time. The Trustees' considered conclusion is that on this assumption there would be no reasonable prospect of a successful reorganization of the Debtor. The *present* Penn Central plant, burdened with *uneconomic lines,* manned by *redundant labor,* and absorbing continued *passenger service deficits,* could not be put back in shape within the time available, or perhaps ever.

This conclusion is based essentially on a study forecasting Penn Central's revenues and expenses up to 1976 on the assumption that there would be no important progress in dealing with the three principal external constraints previously referred to.

The study has taken into account (i) predictions as to future traffic on a detailed commodity by commodity basis, checked against inquiries as to the expectations of major shippers; (ii) various available economic models providing overall predictions as to the economy, with particular reference to the northeastern United States; (iii) the vulnerability of rail traffic generally to competition; and (iv) the probable effects of wage and price inflation on the Debtor and on competitive modes of transportation. The study hypothesizes significant increases in traffic — which are believed reasonable.

The key element in such projections is, of course, the volume of traffic to be expected in future years. The Trustees have retained the firm of Temple, Barker & Sloane to project traffic and business trends over the next decade. For purposes of this Report, it was necessary to make the best informed judgment possible on the short-term prospects of volume. After exhaustive discussions and analyses with the management, staff and independent consultants, it appears reasonable to the Trustees to predict that freight volume will reach between 307 million and 322 million tons annually by 1976. A continued growth is anticipated beyond that time, but at a slower pace.

While the study predicts some net railway operating income for the first time in 1975 and 1976, the amount is not large enough, soon enough, or certain enough to permit

serious consideration of reorganization on the existing system basis. Major unpaid post-bankruptcy claims would continue to accumulate until 1975.

The study does not project sufficient income available for fixed charges in 1976, in the judgment of the Trustees, to support new securities sufficient, after post-bankruptcy claims and equipment debt were satisfied, to assure anything of substance for pre-bankruptcy interests.

2. The key question thus becomes whether Penn Central can be successfully reorganized, *if reasonable and reasonably attainable success is achieved in dealing with the three principal external constraints previously referred to* — a task which will require continuing maximum efforts of management and Trustees *and* critically necessary cooperation of others.

The Trustees advise the Court that the Penn Central *can* be successfully reorganized if the requisite changes are made, and furthermore that there is reasonable prospect of their being made. As to that prospect, however, it is the Trustees' understanding that the Court contemplates — by the procedure prescribed for the distribution of this Report — that a fuller basis for evaluating that prospect will be obtained from the reactions to the Report.

Successful reorganization depends, then, on achieving, in significant degree, three changes.

(a). *Plant Rationalization.* The Penn Central track system must be restructured (i) to realize the increased efficiency made possible by the 1968 merger, (ii) to eliminate those freight lines the operation of which cannot be justified in terms of either sound business practice or the necessities of public service, and (iii) to make appropriate arrangements for the operation or underwriting of those freight lines which the public interest warrants maintaining but which cannot be operated by Penn Central for its own account.

Penn Central's plant has a much lower traffic density and a much lower freight revenue per mile of line than any other major eastern railroad. When compared with the C&O/B&O and N&W, for instance, Penn Central is lower by 16% to 44%. Penn Central's business volume is too low, and its plant too large. Approximately 80% of the Debtor's 1970 freight operating revenues can be identified with movements between origins and destinations on the railroad (including interchange points with other railroads) linked by approximately 11,000 of the railroad's approximately 20,000 route miles. Had such a "core" been in existence in 1970, it would have had high traffic density and a revenue level per mile of line in keeping with the leading eastern railroads.

Further analysis of this theoretical higher-density "core" in relation to operating practicalities appears to indicate (the studies are still in progress) that a great preponderance of the Debtor's freight traffic could continue to be realized from this "core" system. There is basis for the expectation that further development of this approach, including more refined marketing and operating analysis, will result in some enlargement of the present hypothetical "core" system.

Calculation of the cost of operating such a freight "core" is an extremely complex matter, and the continuing studies will produce more sophisticated estimates on that question.

Those studies will also permit a more precise identification of potential revenues and costs of additional lines. Up to now, because of time pressures, the allocation of costs among the various lines has had to be on a generalized basis, involving system averages in many instances, which may distort the results so far as particular lines are concerned. The Trustees are preparing analyses of larger "core" systems.

The analysis made thus far indicates that, had a "core" freight railroad system of approximately 11,000 route miles been in operation in 1970, and had it retained some 80% of the freight revenues of that year, it would have produced net railway operating income in the neighborhood of $94 million, which, after addition of an approximate $37 million (non-operating income less miscellaneous deductions), would have resulted in

some $131 million of income available for fixed charges. The $94 million income figure contrasts with an actual net railway operating *loss* for that year from freight operations on the existing system of approximately $104 million.

These calculations have been made on the basis of income from freight operations alone, and thus do not reflect the existing losses from passenger service. They also assume various operating efficiencies and economies which were not in effect in 1970, but which have since been put into effect.

The "core" concept does not assume termination of all facilities on the remainder of the Debtor's present system. Other lines in the system may, on the basis of the studies presently under way, properly form part of, or be operated by, a reorganized Penn Central. They may, in the alternative, remain in operation through acquisition or underwriting either by other interests including shippers, or by local governmental bodies. In the latter case, the rail service could be operated either independently or by Penn Central under contract, or through other arrangements which would be fully compensatory. In addition, piggyback arrangements can be expanded to provide freight service to many localities and industries presently served by uneconomic branch lines.

The plan of reorganization itself, when approved, as it must be, by the Interstate Commerce Commission, can provide the necessary authority and procedure for much of this restructuring. The Commission can approve a plan of reorganization which authorizes the abandonment of lines if no compensatory basis can be obtained for their continuance. The plan can provide, in order to protect the public interest, that any line so designated for abandonment be operated for a reasonable time to enable interested parties to submit proposals for compensating Penn Central for continued operations. It can provide, to the extent necessary, renegotiated arrangements with leased lines to permit operations on them to continue. And it can provide for sale to or operation of segments by other interests whenever specific terms have been arrived at prior to approval of the final plan.

The Trustees recognize that the feasibility of contract services with public bodies depends on requisite appropriations being made at the local, state, regional or perhaps Federal level.

(b). *Work Force.* A second condition which must be met to achieve a successful reorganization of the Debtor is a major reduction in its work force.

Management has recognized this, and in respect of employment within its control, has achieved significant reductions, as indicated above, and contemplates further reductions.

Excess manpower remains in areas where Penn Central confronts restraints imposed both by labor agreements and by state "full-crew" laws. These agreements and laws involve outdated requirements for the use of firemen on locomotives in freight and yard service, and constraints against reducing the number of trainmen or yardmen assigned to road and yard crews.

The Penn Central position is that normal freight road and yard operations require a train and engine crew of *no more than* three men. On this basis, Penn Central employs approximately 9,800 crewmen in excess of those needed for safe and efficient operation.

Almost half of these 9,800 train and engine service crewmen are in Ohio and Indiana.

The Trustees' evaluation of this situation is reinforced by the results of the national manning dispute which culminated in the 1963 award of Arbitration Board No. 282 created by Act of Congress. That award found that firemen were not required in yard and freight service except on a relatively few engine assignments. It also found substantial overmanning of trains and established a procedure, which expired in 1966, for independent third-party determination of the consist of yard and branch line freight train crews. Arbitrations under this procedure, including many on lines of the Penn Central, found two trainmen appropriate in most instances. Operations pursuant to these awards were entirely satisfactory from the standpoint of safety and efficiency.

In the case of excess firemen, the history and current status of this long-standing dispute was described in the Trustees' Report of August 31, 1971 to the Court. It will suffice to note here that Presidential Emergency Board No. 177 concluded that:

> "It was unanimously found by the public neutral members of all previous boards that there is no need for firemen on freight and yard diesel locomotives except under rare operating conditions.
>
> "The new evidence presented to this Board is not sufficiently compelling to warrant a contrary conclusion.....Neither the new evidence relating to safety or work burden supports the asserted need for restoration of firemen."

At projected 1972 wage and employment levels, excess labor adds about $150 million to the Penn Central's annual costs.

(c). *Passenger Service.* The third change required for a successful reorganization is the elimination of the large continuing drain from passenger service, both intercity and commutation. The Trustees do not seek to discontinue such service. Their position is simply that the passenger service which is to be continued cannot be permitted to remain a financial burden.

It is widely assumed that Amtrak has relieved the railroad of unprofitable intercity passenger service. However, Penn Central is in fact subject to a continuing major drain on its resources in supplying this service.

While the Trustees will continue their efforts to secure proper reimbursement under the present Amtrak contract, they believe that its terms do not reflect accurately the special characteristics of the Boston-Washington corridor. The present contract, for example, does not provide for any sharing between Amtrak and other services of common maintenance-of-way costs — despite the fact that passenger service accounts for more than two-thirds of the train miles operated in the corridor. With only minor exceptions, all main trackage is used jointly by intercity, commuter and freight services. Even on that part of the corridor where freight traffic is the heaviest, two main tracks would suffice for that traffic; but the demands of the passenger service are such that up to six tracks are required.

Nor does the present contract permit any charge to Amtrak for common costs incurred in providing passenger service. The "avoidable cost" concept now incorporated in the Amtrak contract means that in situations in which Penn Central's tracks are used for freight, intercity passenger, and commuter service, Penn Central has to pay 100% of the costs which ought to be allocated among all three services. Finally, the present Amtrak contract gives no recognition whatever to investment in property used in the passenger service.

The basis of compensation in the present contract is subject to change July 1, 1973, for which purpose negotiations may begin in May 1972. The Trustees will seek appropriate changes in the Penn Central contract. They recognize that Amtrak has not been adequately funded to meet the additional reimbursement which is warranted. Some form of relief from the burdens of intercity passenger service *must* nevertheless be provided. Until it is, the contract payments fall short, on the basis of fully allocated costs, by approximately $32.5 million per year at 1972 levels of service, wages and prices, exclusive of return on investment.

There is increasing recognition that commuter services are indispensable to many major metropolitan areas. In spite of this, the Trustees estimate that at 1972 levels of service, wages, and revenues from all sources, Penn Central's commuter service was rendered at a loss of $54.7 million relative to fully allocated costs, exclusive of return on investment. (Fare increases pending or in preparation, if effectuated promptly, would reduce this figure by an estimated $10 million.)

The combined effects of intercity and commutation passenger service are thus imposing a burden of $87.2 million, not including return on investment.

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This analysis of what is required to put Penn Central on a viable basis is regrettably involved. But there are no short-cuts to the right answers — except across quicksand.

What this all comes down to is that on the "core" basis described above, with passenger costs fully compensated (exclusive of return on investment) and unnecessary labor costs eliminated, Penn Central would have produced, on 1970 traffic levels, net railway operating income of approximately $181 million — instead of the $237 million net railway operating loss actually incurred in that year.

This analysis has been prepared entirely on the basis of 1970 freight rates, revenues and costs. It remains to project its results to 1976. On an extremely rough basis it can be estimated that, with the plant rationalized and all passenger costs compensated and unnecessary labor costs eliminated, income available for fixed charges by 1976, including non-operating income, will be — depending on the traffic volume assumed — between $220 million (at 1970 traffic levels) and $290 million (at management's 1976 projected traffic levels).

These figures assume that the changes are made promptly enough to make their effects *fully available* by the beginning of 1976. Because of the time required to realize those effects, implementation of the Trustees' proposals will have to begin promptly in order to produce the indicated results by 1976.

Elimination of the further constraints on viability which are referred to in Section I would contribute further to a successful reorganization.

The figures projected in this section as income available for fixed charges exclude income from assets owned by Pennsylvania Company but include income from the Debtor's other non-rail assets. The continued availability of such income for railroad operations cannot be ensured if the railroad cannot ultimately be made viable.

The Trustees have proceeded aggressively toward the liquidation of non-rail assets, on the basis that the implementation of the proposals in this Report will create a situation in which the proceeds from the sale of such assets may be used for purposes relevant to the restoration of the viability of the Penn Central.

B. Can Such a Plan Be Consummated Soon Enough To Be Practicable, Fair and Equitable, and Constitutional?

The second aspect of feasibility — whether a plan can be consummated within an acceptable period of time — raises additional questions. The Trustees believe, however, that it can be, *if the necessary changes are made promptly.*

The problem arises from the continuing accumulation of unpaid administration claims which has been taking place since bankruptcy. Although the rate of operating losses has decreased, service of equipment debt has been maintained and the cash position has stabilized, the estate available for pre-bankruptcy creditor and equity interests has been diminished through the end of 1971 by approximately $100 million in accumulated post-bankruptcy real estate and corporate taxes, $75 million thus far in the Trustees' Federally guaranteed borrowing, and up to $50 million in leased line rentals under leases which may eventually be affirmed. Thus, the estate available for such pre-bankruptcy interests has already been diminished by up to $225 million from these factors.

On the present basis, unpaid administration claims are continuing to accumulate at the rate of about $100 million per year. This diminution of value affects most adversely the junior pre-bankruptcy interests which are not protected by liens.

It should be recognized that asset values have been enhanced by capital improvements and reductions in the principal indebtedness on equipment obligations. Yet continued accumulation of high priority administration debts cannot continue indefinitely.

On the other hand, if there is, as the Trustees believe, a reasonable probability that a plan of reorganization can be formulated which will both provide for the post-bankruptcy obligations, including equipment debt, and produce adequate values for pre-bankruptcy interests. deferral of administration claims can continue for a reasonable time so as to permit attainment of that prospect.

In a plan of reorganization, the values for pre-bankruptcy interests should be at least in a fair equivalence to the liquidation value of the estate. Those who invested in or lent money to a regulated utility may be forced to make some sacrifice, but it is not acceptable that the entirety of pre-bankruptcy interests be wiped out if substantial values could have been preserved for them by liquidation.

The Trustees have given careful but not as yet fully conclusive consideration to the remarkable, indeed startling, variety of valuation estimates which result from invoking one theory of valuation or another.

Although cessation of rail operations over the entire Penn Central system is an unreal prospect, the Trustees have for purposes of analysis commissioned studies of the scrap value of physical assets and the present discounted value for non-rail purposes of other assets in order to provide the Court and interested parties with the basis for a judgment as to the minimum values which are approached as a limit as one assumes less and less of the Penn Central system continued in rail service. As is summarized in Exhibit B, the present discounted value of the Penn Central Transportation Company for scrap and other non-rail purposes, plus the net value of its interests in other companies, is in the range of $1.427 billion to $1.858 billion.

Yet it is possible, on a reproduction-cost-less-net-depreciation theory approach, to reach a figure as high as $14 billion for the entire Penn Central system, including leased lines and operating subsidiaries. That figure has no presently practical meaning.

The liquidation value of the property owned by the Debtor, including the net value of its interests in other companies, depends in large part on what assumptions are made as to how much of the existing Penn Central system would be taken and continued in operation for railroad purposes by governmental agencies, other private-enterprise railroads, or both.

Portions of the Penn Central system may have substantial enterprise values, particularly if there is taken into account, in assessing such values for purposes of a governmental taking, those elements of value which have been reduced or eliminated as a result of governmentally imposed constraints. It might be assumed, if only for purposes of analysis, that rail service would be continued on portions of the system on a basis involving reasonable compensation. It is also possible that substantial prices might be paid for individual segments by other railroads.

On the other hand, liquidation values for portions of the system where rail service would not be continued would be held down by a number of factors. Most of the bridges and tunnels and some of the buildings in the Penn Central system have no value for purposes other than railroad purposes, and a substantial portion of the real property interests is held under easements or other titles providing for reversions if and when rail operations cease. Furthermore, the very substantial real property assembled in the Penn Central system could not be disposed of for non-rail purposes except over a substantial period of time and with substantial expenses for holding and disposition. As a result, the discounted present value of real property interests for disposition for non-rail purposes would be far less than the aggregate present value of the parcels to be disposed of.

Assuming the actions identified in this Report as necessary are taken within a reasonable time, the accumulation of prior charges against the estate available for pre-bankruptcy interests could be stopped. The benefits of passenger service relief would reduce losses from the moment such benefits were obtained, even though the benefits from concentration of plant and changes in work rules would take some time to be fully realized after the right to make the changes had been established.

Once the benefits from the action proposed by the Trustees have been substantially realized, there will be significant income available for fixed charges. All projections are subject to infirmities. However, the order of magnitude of projected income available for fixed charges — from $220 million to $290 million — would support a new capital structure for a reorganized Penn Central adequate to cover post-bankruptcy claims and equipment debt and still provide pre-bankruptcy interests protection greater than they would receive from any *assured* liquidation value of the estate.

The values to be achieved for pre-bankruptcy interests in the proposed reorganization cannot be attained, however, unless the three obstacles to viability are substantially and promptly overcome. It should be possible for Federal, state and local governments and all interested parties to analyze the situation as presented in this Report and to come to conclusions as to whether they are prepared to cooperate in achieving the changes necessary to allow the Penn Central to continue as a private enterprise. If an adequate response should not be forthcoming, the Trustees will be prepared to advise the Court that this reorganization proceeding is producing a result for which Section 77 was not intended and could not constitutionally have been intended. We do not expect that default.

III. VARIOUS ALTERNATIVES IN THE EVENT A TYPICAL, INCOME-BASED REORGANIZATION APPEARS UNLIKELY

The Trustees have stated their firm belief that an income-based plan of reorganization is feasible. It clearly is, unless there is a failure of response and cooperation.

Nationalization of the Penn Central would be error compounded. Nationalization of this railroad in its present condition would as a practical matter perpetuate the inefficiencies and inadequacies which the Trustees' proposals would eliminate. The cost to the American taxpayers would be, furthermore, literally billions of dollars. Even if the Government moved in such a way as to hold the cost of acquisition to the lowest possible level, the value of Penn Central's assets for further railroad use would be enormous.

There are "intermediate" possibilities of one kind or another which would arguably not involve, *in themselves*, "nationalization." But if they were taken it would be, as the Trustees view this situation, only the consequence of failure to face up to the hard but plain imperatives that the *right* things be done. They would be in essentially the same pattern of improvisation — resorting to interim patches and palliatives in order to postpone the day of ultimate reckoning — which carried the Penn Central into bankruptcy. The reorganization approach proposed by the Trustees is simply to make Penn Central a system which makes sense and to operate it with the employees it needs.

It would be the worst mistake, with the Penn Central in its present extremity, not to use that extremity to do all that needs to be done. Resorting instead to measures which would only buy a little more time would be wrong.

Although the Trustees have necessarily and properly focused their consideration on the interests directly involved in these proceedings, they have recognized this case as presenting — in the public's mind and indeed in fact — the issue of whether free enterprise, incorporated and unionized, is going to work.

A country which may have momentarily lost some of its essential self-confidence would take what could well prove infectious pride and satisfaction from seeing this crippled corporate giant put back on its own feet and made to stand upright. That just makes sense.

Respectfully submitted,

/s/ George P. Baker

George P. Baker

/s/ Richard C. Bond

Richard C. Bond

/s/ Jervis Langdon, Jr.

Jervis Langdon, Jr.

/s/ Willard Wirtz

Willard Wirtz

/s/ Robert W. Blanchette

Robert W. Blanchette
Counsel for Trustees

/s/ Covington & Burling

Covington & Burling
Special Counsel for Trustees

February 15, 1972

Exhibit A

A REPORT ON 1971

by

William H. Moore
President

Penn Central Transportation Company

FINANCIAL PICTURE

The year 1971 was marked by a careful husbanding of Penn Central's cash resources. While the railroad is still suffering a cash drain, a spartan management program has resulted in noteworthy progress since the railroad's reorganization began. As a result, the Trustees were able, on December 9, 1971, to advise United States Senator Vance Hartke, Chairman of the Senate Subcommittee on Surface Transportation as follows:

> "So far this year Penn Central has drawn down $75 million of the $100 million guaranteed loan made possible by the Emergency Rail Transportation Act of 1970, and our planning had contemplated that the remaining $25 million would be needed in the month of December, 1971. The present prospect is, however, that we can forego the $25 million credit in 1971 and have $35 million in cash at the end of the year.
>
> "It is still contemplated that Penn Central will have a sizeable cash drain in the first quarter of 1972. With the availability of the $25 million credit just referred to, Penn Central, given reasonably good luck should be able to survive this first quarter without further borrowing, although, in order to be safe, we may be compelled to seek the Court's permission to apply for a so-called Amtrak loan under the Rail Passenger Service Act of 1970.
>
> "Once past the first quarter, Penn Central should be able to make the rest of the year but only on a bankruptcy basis with the continued deferral of State and local taxes, leased line rentals, and other obligations. When such additional payments can no longer be deferred, Penn Central faces another cash problem which we are planning to deal with in the reorganization plan to the filed April 1, 1972."

There has also been improvement in reducing deficits. For the entire year 1971 the deficit, on a fully accrued basis and before extraordinary items, is estimated at $275,000,000 as compared with a deficit of $325,739,148 for 1970.

Because of freight rate increases granted during the year and a more favorable traffic mix, revenues for the first 10 months of 1971 (latest figures available) were $1,290 millions compared to $1,176 millions for the same 1970 period. This, however, was greatly offset by a sharp decline in traffic volume and staggering increases in wage rates and cost of materials.

In the generally slack national economy, freight traffic volume for the first 10 months of 1971 decreased 6.5 per cent in net ton miles, or from 72 to 67 billions. For the full year the decrease, including the devasting effect of the coal and dock strikes, may be even greater.

Penn Central was faced with the following cost increases:

Increased Costs 1971 Over 1970

1. Wage increases	$86.9	(million)
2. Material price increases	9.3	
3. Payroll tax	7.1	
4. Health and Welfare	7.0	
Total	$110.3	

It is significant that Penn Central has shown any improvement in the face of these two adverse factors (decline in volume and cost increases).

A significant reason for the improvement is a close control of expenses which for the first ten months of 1971 produced a reduction in the operating ratio (percentage of operating revenues consumed by operating expenses) from 91.76 to 88.06 per cent. Most of this improvement occurred in the freight transportation ratio, down from 48.2 to 44.6 per cent.

Reflected in these improved ratios are reductions in personnel. The average employment in 1970 was 93,788 and our target for 1971 has been an average of 87,900. But so far Penn Central is ahead of target. We should end the year with an employment of about 84,300, or 1,000 less than our year-end goal of 85,300.

The financial drain from passenger service was partially curtailed during the year. In addition to an estimated $16 million in net cash payments during the year from Amtrak, the National Railroad Passenger Corporation, the railroad also realized net benefits of approximately $8.5 million on an avoidable cost basis from discontinuance of unprofitable intercity passenger trains not selected for the Amtrak network.

We are definitely making progress—solid progress. But it cannot be concluded that the Penn Central crisis has passed. Our progress must not obscure the fact that the railroad is deferring many priority claims, principally taxes, for which provision on a current basis cannot be indefinitely postponed.

As noted earlier, we expect a temporary financial crunch to occur sometime in March or April of 1972. However, if the 2.5% emergency freight rate increase and further selective increases are granted without undue delay and if business picks up as predicted by many economists, the railroad should be able to operate through 1972 without infusion of cash from outside sources.

EQUIPMENT ACQUISITION AND REPAIR

Two key steps in restoring good service to the railroad are:

1. Equipment acquisition and repair to meet customer requirements.

2. Increased property maintenance for greater transportation speed and efficiency.

The added financial stringencies imposed, as the year progressed, by a discouraging national economic picture and strikes in key industries, forced us to curtail some programs of equipment and roadway maintenance. Nevertheless, Penn Central will begin 1972 with sufficient transportation capacity to handle substantially more traffic—which we are determined to get. A continuing program of equipment acquisition and maintenance of right-of-way has been laid out for 1972, within our financial limitations.

During the past year, Penn Central acquired some 7,500 new freight cars and 187 locomotives through long-term lease arrangements.

By the end of 1971 we will have rebuilt and made heavy repairs on some 11,400 freight cars, and upgraded and additional 11,470 freight cars, a total of 22,870 cars. The $39.6 million spent for these programs was paid out of operating revenue, whereas in 1970 much of this work was financed with borrowed funds.

In 1972, we plan to acquire, through long-term leasing, 6,700 new freight cars, including general service box cars, equipped cars (for high value merchandise), covered

hoppers (for grain), and some 1,500 open top hoppers (mainly for coal and ore), valued at $130 million.

The railroad plans to rebuild 1,000 freight cars, make heavy repairs on 6,940 and upgrade 6,900 more, for a total of 14,840 in 1972.

These amounts are calculated to meet volume forecasts, taking into account that during the year Penn Central will also scrap 8,200 freight cars which are beyond repair.

The railroad also plans long-term lease of 200 new locomotives in 1972 valued at $47.8 million.

IMPROVEMENT OF ROADWAY AND FACILITIES

The railroad has continued to make essential improvements in plant despite severe restrictions imposed by bankruptcy law on the normal use of proceeds from sales of real estate and other assets for such purposes.

This year we laid 53,000 tons of new rail (or 218 miles) vs. 49,000 tons (or 200 miles) in 1970. We plan to match our 1971 program in 1972.

In 1972 we are budgeting $15.5 million for yard improvements, including continued work at our key Midwest gateway classification yard at Elkhart, Ind., our Selkirk, N.Y., classification yard, and our Buckeye Yard at Columbus, Ohio.

TRANSPORTATION SERVICE

The vast improvements in our service made during 1971 have restored the respect and confidence of shippers. We are delivering their cars without delays, and have greatly reduced costly derailments. Post-bankrtupcy claims are now being settled on a current basis.

We initiated a quality control system using computer analysis to monitor our daily performance and are now checking tens of thousands of cars each week, moving from 232 terminals which originate volume shipments. This enables us to pinpoint trouble spots immediately and take quick corrective action.

We are running more and shorter trains which speed delivery to terminals and interchange connections. This gives us faster turnaround of equipment, and in turn, greater car utilization. It also reduces yard congestion and overtime expenses. Even with substantially more train service and increased wage and material costs, total transportation expenses in 1971 were about the same as in 1970.

In the first 11 months of 1971 the railroad ran 20,000 more trains than for the same period in 1970, or an increase 5 per cent. Our average train speed has increased by about 12 per cent. Our car days on line per loaded cars handled decreased by 7.5 per cent.

Our on-time performance in making interline connections has improved sharply. In the first nine months of 1971, for example, Penn Central trains made connections at Chicago 82 per cent of the time, vs. 55 per cent in 1970, and at Cincinnati, 88 per cent of the time in 1971 vs. 72 per cent in 1970.

Greater availability of locomotives helped to make this possible. Working on a much faster turnaround time for equipment repair, cur shops reduced locomotives undergoing and awaiting repairs by some 36 per cent (October 31, 1971, vs. October 31, 1970). The percentage of locomotives out of service of the total fleet was 6.5 per cent vs. 10.1 per cent for the same time in 1970.

The same program of speeded-up repair and better utilization of equipment made the equivalent of many hundreds of extra operable freight cars available to customers.

The increasing effectiveness of Penn Central's maintenance and inspection program helped the railroad cut its major accidents for the first nine months of the year by almost 50 per cent, as compared to the same period in 1970.

One of the most gratifying results in 1971 railroad operations is our growing file of complimentary letters from shippers. During the year, our service complaints have declined from an average of 50 a week to four or five a week at year-end, with steady improvement throughout the year.

SALES AND MARKETING PROGRAMS

With first-rate service to sell, the company launched an innovative sales and marketing campaign—including selective rate reductions, new services and more trains, and new opportunities in industrial development for our customers. Our objective is to meet and outperform competitors.

Selective Rate Reductions

On June 19, 1971, we made across-the-board cuts in our TrailVan (piggyback) Plan II 1/2 and III ramp-to-ramp rates, averaging about 6 per cent. Since that time a 6.1 per cent cumulative decrease in this type traffic (compared to the same period in 1970) has turned into a slight cumulative increase (as of the end of October), despite the dock strike and depressed economy. We expect to strengthen this upswing in 1972.

More recently, Eastern railroads (including Penn Central) jointly approved a new scale of iron and steel hauling rates, with an average rollback of 8 per cent. Penn Central hauls $ 100 million of this traffic annually, and with the new rates tailored to be competitive with truck industry rates in quantities of 40,000 pounds or more, we stand to gain a great deal more of this traffic. We will implement the new rate structure on January 8, 1972.

Grain hauling has benefited from the virtual doubling of our fleet and from substantial rate changes to accommodate our shippers. This is sparking a strong comeback in recovery of grain tonnage, which is best indicated by the fact that in the last quarter of 1971 our grain business will have doubled, vs. the same period of 1970.

More Trains and New Services

In 1971 Penn Central was able to schedule 42 new trains—all aimed at either substantially improving present service or at offering new service where volume potential exists or new services to specific customers.

We are rebuilding our TrailVan (piggyback) service which dropped in volume during 1970 and early 1971. As noted, we cut rates in several areas and we also improved our overall on-time performance by 30 per cent. We increased our all-TrailVan trains by more than 15 per cent, adding six new schedules in the past year. Examples are new services between New York and Boston, between New York and Rochester-Buffalo, and between Chicago and Cincinnati.

In preparation for an expected substantial upturn in TrailVan traffic, we are doubling our capacity to handle traffic at the Kearny TrailVan terminal near New York. We have expanded our Kearny gatehouse from four to seven lanes, and have provided space for 40 more working car spots to be serviced with four "piggypacker" loading cranes. We are completing an additional 50-car track at North Kearny for loading and unloading, with storage space for 400 additional trailers.

In another area, Penn Central increased its Flexi-Flo tonnage more than 30 per cent in 1971, and has even greater expectations for 1972. Flexi-Flo is a coordinated rail-highway service for high-value bulk commodities such as chemicals, foods and cement, and is operated to and from 12 key geographical distribution points.

In 1972, we will substantially expand the Flexi-Flo program, by establishing terminals in several more cities (including Philadelphia), and enlarging our existing terminals.

Penn Central has started and will expand in 1972 an entirely new service to its shippers called FACTerminal.

Freight agents serving specified territories will be able to move about freely to render "on-the-ground" services to shippers. Backup computer and communications equipment to support these agents will be installed in key cities across the railroad system in "Freight Agency Coordinated Terminals" (FACT) to centralize all paperwork. We will better serve our shippers through more efficient use of our employees and improved supervision of transportation functions. We estimate that the FACTerminal program can save the railroad several million dollars annually.

Industrial Development

In the first 10 months of 1971 Penn Central helped locate on its lines 411 new, temporary or expanded industrial facilities, with investment totaling $668 million. These plants create jobs in local communities, as well as build our traffic volume.

For 1972, some 295 industries have already expressed bona fide interest in locating along our lines. We expect continuing heavy activity as the year goes on.

We are making a special effort to encourage new industrial parks along our lines. We now serve 302 industrial parks, which have some 70,000 acres available for plant locations. Also, our Penn Central "land bank" offers 188 separate parcels in 14 different states totaling about 20,000 acres for new industries.

EXCESS CREW LAWS

In collaboration with other railroads, we are continuing our vigorous efforts to obtain repeal of antiquated state laws requiring unnecessary personnel on freight train operating crews. In Penn Central territory, these laws are now in force in only two states, Ohio and Indiana. A New York law requiring a freight train crew of five men was repealed during 1971.

Ohio requires a five-man crew. Indiana requires a six-man crew on freight trains of 70 cars or more. These two laws cost Penn Central approximately $25 million in 1971.

A Bill to repeal the Ohio law has passed the House and has been carried over for action in January, 1972, by the State Senate. A repeal Bill has been filed with the Indiana General Assembly and will be before the 1972 Session when it convenes in January.

Savings inherent in repeal of these laws will not be realized until settlement on a national basis of the locomotive firemen issue and displacement through attrition of employees involved.

PROGRAM TO RATIONALIZE THE PLANT

Studies are underway to determine the viable sections of the Penn Central. In this regard more than 90 per cent of our gross ton miles is handled on about 60 per cent of our route mileage. However these studies may come out, it is vitally important that we discontinue non-productive lines which cannot be justified.

To date, we have determined there are 163 such lines covering 1,732 miles of railroad. Applications for abandonment of 117 of these lines have already been submitted to the Interstate Commerce Commission. We have orders approving 45 of them. Approximately 3,000 additional miles of line are being studied to determine whether abandonment should be proposed.

In continuing studies, we will consider several thousand miles of feeder and tributary segments of our railroad. We need to weed out functionally duplicative lines and mileage not required in terms of future traffic patterns.

AMTRAK CONTRACT SERVICE

Since May 1, payments from Amtrak for intercity passenger service have aided our cash flow. By the end of the year we will have received an estimated $16 million in net cash payments, after provision for our monthly payments on purchase of Amtrak stock in order to join the corporation.

We feel there is inadequate compensation for us in the present contract especially in the Northeast Corridor for passenger expenses we incur which are common with freight service such as maintenance of way, signaling, communications, etc.

We hope during 1972 to being renegotiating our present contract with Amtrak to provide more adequate compensation for our costs of these operations.

COMMUTER SERVICE

During 1971, Penn Central continued to move in all of its commuter areas toward the assumption by public authorities of total financial responsiblity for providing these essential passenger services. Until this objective is accomplished, our commuter service deficits are being minimized through a variety of contractual agreements with State or

regional transportation authorities in Boston, New York, Philadelphia, and northern New Jersey.

We are trying in Boston and northern New Jersey to have reinstated fare increases granted but suspended because of the national economic program. A 3 per cent increase on the New Haven Division will become effective on January 1 and a fare increase in the Philadelphia area is pending.

On January 1, 1971, we entered into agreement with the States of New York and Connecticut for these States to assume the former New Haven commuter service between New York City and New Haven, Connecticut.

A similar agreement with New York State for commuter services on our Hudson and Harlem branches was recently disapproved by the U. S. District Court in charge of our reorganization. We are now working to resolve this problem.

In the Philadelphia area, the Southeastern Pennsylvania Transportation Authority has recognized in our 1970–71 contract many more of our avoidable expenses. Our current contract includes an understanding that SEPTA will assume full financial responsibility for operating this service after July 1, 1972.

In northern New Jersey, where 83 passenger cars have been purchased with State funds, we are negotiating for additional State aid and have begun work on a plan for takeover by the State of the North Jersey Coast service.

In Boston, we are negotiating with the Massachusetts Bay Transportation Authority for continuation of that city's rail commuter network on a permanent basis. At the same time, we are working out arrangements for keeping this service operating until a takeover is accomplished.

BUSINESS AND LABOR CLIMATE — 1972

In 1971 Penn Central received $170 million less in revenues than originally projected, mainly because of strikes in key industries and the generally sluggish national economy.

The 1972 outlook in this regard is much brighter. All major industries served by the Penn Central (such as autos, steel, coal) have contracts with labor unions which run at least through the whole year. Moreover, many economic experts in the nation look for a business upturn in 1972, and this should add to the railroad's gross revenues.

A 5 per cent increase in gross revenues would bring in approximately $90 million more. Each percentage point increase above that could add $18 million.

Penn Central would be a major beneficiary if 1972 brings good business and peaceful labor relations.

SALES PROSPECTS FOR 1972

Penn Central is geared in 1972 to handle a much greater volume of business while sustaining the same high standards of service the railroad achieved in 1971.

In the year ahead, we will seek greater, profitable traffic volume, for we now have the capacity to handle substantial increases with a minimum increase in transportation expense. We intend to be fully competitive vis a vis other modes of transportation by selective freight rate increases and decreases (where warranted), in combination with special services tailored to individual shipper and commodity requirements.

In summary, during 1971 Penn Central became notably more competitive in all aspects of its operations. Our sales program in 1972 will reflect our renewed capabilities.

December 22, 1971

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EXHIBIT B

PRELIMINARY STUDY OF VALUE FOR NON-RAILROAD PURPOSES OF PENN CENTRAL TRANSPORTATION COMPANY ASSETS AS OF DECEMBER 31, 1970

The following analysis assumes a complete cessation of operations by Penn Central Transportation Company and its leased lines. Substantial continued railroad service is a much more likely assumption which would produce higher values, but the extent of the increase would depend on how much railroad service would be continued and on what basis.

Where indicated, a discount has been applied to the disposition price to reflect not only the estimated expenses of holding and disposing of the assets, but also the present value of future receipts from non-productive property.

Two alternative discounts have been applied to real property. Each represents different assumptions as to the present value of future money, expenses to be incurred, and the length of time it would take to dispose of real property held by all companies within the system.

No additional discount has been applied to reflect economic disruption which would result if there actually were a sudden and complete cessation of rail operations on the Penn Central system.

System-wide assumptions as to disposition time and selling expenses for real property have been used, even though quite different times and expenses may be expected for property of different values and different locales. A more precise analysis could produce materially different results as to individual mortgage segments and individual leased lines

1. Assets owned directly by Penn Central Transportation Company:

a. Real property exclusive of investment properties in the vicinity of Grand Central Terminal on Park Avenue, New York City, after applying a 50% discount to account for time and expenses of disposition.	$631,000,000	
a.(i) Same as above with a 72% discount.		$354,000,000
b. Investment properties in the vicinity of Grand Central Terminal based on capitalization of earnings for properties subject to long-term lease, and, for other properties, highest and best use less a 15% discount to account for disposition time and expense.	$153,000,000	
c. Buildings after applying a 61% discount to account for time and expenses of disposition.	$ 34,000,000	

d. Owned operating equipment before deduction of equipment financing liens, discounted 18% to account for time and expenses of disposition.	$476,000,000	
e. Track discounted 50% to account for time and expenses of disposition.	$ 51,000,000	
f. Materials and supplies discounted 5% to account for time and expenses of disposition.	$ 40,000,000	
g. Other miscellaneous physical assets, all of which could be disposed of without substantial expense.	$ 28,000,000	
h. The closing or dismantling expense for tunnels, bridges and electrical traction facilities after deducting the scrap value of the materials.	($166,000,000)	
i. Net current assets at December 31, 1970.	$ 25,000,000	
j. Deferred charges and other miscellaneous assets.	nominal	
2. Interest of Penn Central Transportation Company (as a stockholder and in some cases a creditor) in subsidiaries other than leased lines that would probably be liquidated upon the cessation of PCTC operations, the assets of each subsidiary having been valued in the same manner as were the assets owned directly by Penn Central Transportation Company, after applying a 50% discount to the subsidiaries' real property to account for time and expenses of disposition.	$ 12,000,000	
2.(i) Same as 2 above with a 72% discount.		$ 7,000,000

3. Interest of Penn Central Transportation Company (as a stockholder and in some cases a creditor) in subsidiaries other than leased lines that would probably not be liquidated in the event of cessation of PCTC operations, the value of the equity ownership having been based upon capitalization of earnings plus, where appropriate, the value of non-income-producing properties, and after applying a 30% discount to account for the time and expenses of disposition of such interests. (Pennsylvania Company, a wholly owned subsidiary, has been excluded because negotiations are under way which may result in the disposition by the Trustees of all of the stock of that company, all of which stock is presently pledged to secure indebtedness.)

$270,000,000

4. Interests of Penn Central Transportation Company (as a stockholder and in some cases a creditor) in companies that are the lessors of railroads leased to it and operated as parts of the Penn Central railroad system, assuming complete cessation of operations would result in termination of the leases and therefore valuing the assets of each company on the same basis as were the directly owned assets of Penn Central Transportation Company, with a 50% discount having been applied to real estate to account for the time and expenses of disposition.

$304,000,000

4.(i) Same as 4 above with a 72% discount.

$155,000,000

Total value of Penn Central Transportation Company assets with a 50% discount applied to account for time and expenses of real estate disposition as indicated above.

$1,858,000,000

Total value of Penn Central Transportation Company assets with a 72% discount applied to account for time and expenses of real estate disposition as indicated above.

$1,427,000,000

EXHIBIT 55

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In the Matter of	:	In Proceedings for the
	:	Reorganization of a
PENN CENTRAL TRANSPORTATION	:	Railroad
COMPANY,	:	
Debtor	:	No. 70—347

TRUSTEES' INTERIM REPORT OF OCTOBER 1, 1972

The Plan for Reorganization filed by the Trustees on April 1, 1972 depends on timely relief in eliminating unnecessary employee expense, losses on passenger service and uneconomic freight lines, and on progress in attracting more traffic and moving it with greater efficiency. The first of the periodic reports on these matters, filed on July 1, 1972, and supplemented on August 2, 1972, dealt particularly with the progress which had been made in the labor area on the critical crew consist issue. This, the second of the periodic reports, deals particularly with the specific lines to be included in the Trustees' proposed reorganized system.

I
THE PROPOSED FREIGHT SYSTEM

Wyer, Dick & Co. has analyzed and compared hypothetical Penn Central freight systems of approximately 15,000 and 11,000 miles. These studies are now as complete as they can be made from presently available data. The analysis is attached as Annex 1, and income statements based on it are attached as Annex 2.

The studies, it must be emphasized, assume substantial attainment of the prerequisites which the Trustees believe essential to a successful private-income-based reorganization. On those assumptions, set out hereafter at page 2, the 15,000 mile system would produce income available for fixed charges of some $243 million in 1976.

This figure is within the range of $220 million to $290 million in income available for fixed charges which the Trustees have stated permits reorganizing the Debtor on a private-income basis.[1]

On the same assumptions as are made for the larger system, the 11,000-mile system would produce only $~~162~~ million available for fixed charges in 1976, which is below the minimum the Trustees believe to be necessary, even though operationally the 11,000-mile system is superior to the 15,000-mile system. The earnings potential of the smaller, more efficient system is impaired by the vastly increased cost of "labor protection": $177 million in 1976 as compared with $18 million for the 15,000-mile system. This reflects the

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[1]The Trustees' April 1, 1972 Plan for Reorganization uses as a reorganization goal income available for fixed charges "not materially less than $275 million, provided further that reasonably anticipated income available for fixed charges in the year in which the reorganization is consummated and subsequent normal years is not less than $275 million."

In view of the inherent uncertainties of long-range forecasts, the Trustees do not consider the difference between $243 million and $275 million sufficient to warrant a material departure from their Plan for Reorganization. Their financial advisors are of the opinion that the $243 million figure will, with minor adjustments, support the capital structure proposed in the April 1, 1972 Report. Further, the benefits of attrition beyond 1976 would, all else being equal, improve the earnings picture. Finally, any material improvement either in the rate of future inflation or in the railroads' ability to absorb inflationary costs through timely rate increases would bring the figure above $275 million.

At all events, barring any developments which permit an upward revision of the $243 million figure by the time the April 1, 1973 final Plan is filed, the Trustees will then make the necessary adjustments in the proposed capital structure.

expense of retaining on the payroll during a period of attrition employees rendered unnecessary by the reduction in the size of the system.

In time, of course, as attrition took place, all these labor protection costs would disappear. However, attainment of the full benefits of the 11,000-mile system would delay implementation of a reorganization plan well beyond 1976 and would expose the estate to substantial erosion in the meantime. Recognizing this, and recognizing that a longer system will provide greater service, the Trustees have concluded that the 15,000-mile system identified on the map forming part of Annex 1 is the system for which they will plan reorganization. This is essentially the present Penn Central system less the lines identified as "clear losers" in the Trustees' April 1 Report, and also less a few hundred miles of other losing lines.

Despite their conclusion, the Trustees remain very much aware of the superior operating profitability of a higher density system.[2] In the event that labor protection costs could be assumed or mitigated through public assistance, a smaller system would have substantially greater long-term viability. That fact may become significant if the assumptions on which the studies are based fall short of realization.

The results stated for 1976 can be achieved only if the following five objectives, detailed in Annexes 1 and 3, are met:

(1) Realization of the increased freight traffic in the most recent projection by Temple, Barker & Sloane, Inc.[3]

(2) Recapture, through increased freight rates, of a high proportion of inflationary costs.

(3) Complete relief from all burdens attributable to passenger service. The Wyer, Dick studies assume this by identifying the system studied as a "freight only" railroad.

(4) Progress on abandonments sufficiently rapid to reduce the present Penn Central system to the 15,000-mile system by 1976.

(5) Continued elimination through 1976 of all unnecessary trainmen on an attrition basis.

The Trustees are pursuing these objectives as their primary reorganization effort. If in the light of future developments — which will be assessed constantly as they occur — it becomes apparent that realization of these objectives is falling short of expectations to a significant degree, the Trustees will propose an alternative method of dealing with the problem of continuing the operation of the railroad.

A further word is warranted on the current status of the abandonment program. Between July 1970 and September 15, 1972, the Trustees have been authorized by the Court to proceed with abandonment applications covering 3,670.5 route miles. During the same period, the Trustees have applied to the Interstate Commerce Commission for leave to abandon 2,410.8 route miles. Only 685.5 miles have been approved. At that pace, the 15,000-mile system cannot be achieved by 1976. The Commission has proposed standards which would significantly speed up the process. If and when the court challenge to these more liberal abandonment procedures is disposed of, the picture could change.

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[2]Certain features of the analysis suggest that maximum *operating* profitability — on the assumptions made in the Wyer, Dick report — would be achieved by a system somewhere between 11,000 and 15,000 miles. The Trustees have therefore requested study of a system approximately midway between those figures. There is no reason to believe, however, that such an intermediate system would produce as much income available for fixed charges by 1976 as would the 15,000-mile system — again because of labor protection costs.

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[3]The TBS forecast filed with the Trustees' April 1, 1972 Report has been updated by TBS at the request of the Trustees. The most recent report, attached as Annex 3, reduces total tonnage estimates slightly.

However, if it becomes necessary, the Trustees will propose to achieve the required level of abandonments either as a part of the plan of reorganization or as one step of such a plan.

II
ELIMINATION OF UNNECESSARY EMPLOYEES

At the time of the Trustees' July 1 Report, negotiations on the crew consist issue were in progress, but no agreements had been reached. The labor section of that Report, in consequence, was very brief. An agreement was later achieved on the firemen issue, and an interim agreement negotiated on the trainmen issue. It seems appropriate, therefore, to include the details of these settlements in this Report, together with such developments as have since occurred.[4]

1. As to firemen, a final settlement has been achieved on a national basis. On July 19, 1972, the railroads signed an agreement, effective August 1, 1972, the essential terms of which are:

(a) Firemen will be employed in numbers adequate to fulfill the carrier's operating needs "for training, qualification and promotion to the craft of locomotive engineers" and to fulfill the carrier's needs for passenger crews and for hostlers and hostler helpers.

(b) The number of firemen in each seniority district to meet those needs will be determined by a formula, to be recalculated quarterly. If the number of firemen employed in a seniority district exceeds that required under the formula, no additional firemen need be employed in that district, and as attrition occurs the number will be reduced to the formula level.

(c) Existing work rules which impose restrictions on work which can be performed by a fireman will be referred to a Standing Committee (one carrier and one Union member) for examination.

(d) Retirement of firemen at age 65 will be compulsory beginning January 1, 1974.

The carriers and the Union have also entered into an agreement establishing a program to accelerate the training, qualifying and promotion of firemen to the craft of engineer.

These agreements will ultimately reduce the number of engine service employees on Penn Central by about 2,700, with a resultant annual saving in employee costs of $40.2 million at present wage rates.

2. As to excess trainmen, an Interim Agreement has been negotiated which the Trustees hope will lead to a satisfactory final settlement. In June 1971, the Trustees instituted collective bargaining procedures under the Railway Labor Act to eliminate arbitrary and unnecessary requirements as to the number of trainmen needed on freight trains. After all procedures under the Act had been exhausted without reaching agreement, the Court, on July 12, 1972, approved the Trustees' petition for authority to promulgate their notice, and the Trustees announced that the new rule would become effective on July 26. The Union announced it would strike, and also sought an injunction against promulgation in the United States District Court in Washington, D. C.

In its order of July 12, the Court had directed the Trustees to continue to negotiate for a settlement of the issue, and specifically to propose to the Union that some crew reductions be effected during an interim period and that a committee be created to recommend, on the basis of the interim experience, a permanent solution. The Trustees promptly sought further negotiations, and, on July 21, 1972 an arrangement of this sort was agreed to. The substantial terms of the agreement are:

[4]The details of the agreements have been included in a report to the Court dated August 2, 1972.

(a) As attrition occurs, 285 crews now manned with two brakemen will be reduced to one brakeman between August 1 and November 30, 1972 (or later, if attrition does not reach 285 by November 30).

(b) The 285 crews to be reduced will be designated from throughout the Penn Central system by the Union. To be excluded from that designation are crews in commuter service, crews which cannot be reduced by reason of "full crew" laws, and crews on those trains in branch lines or yard service which management believes cannot, having regard for safety and workload, be operated with one brakeman.

(c) A Standing Committee of five, two designated by Penn Central, two by the United Transportation Union, and a Neutral Chairman selected by the parties, is established to encourage further collective bargaining, and in the event no final settlement is reached by November 30, 1972, to set guidelines for a permanent settlement on the basis of the experience with the reduced crews. The parties have agreed on the Rt. Rev. Msgr. George G. Higgins as Neutral Chairman. Monsignor Higgins, of the U. S. Catholic Conference, has an extensive background as impartial chairman and mediator in labor-management matters, especially in the railroad industry.

The Court has approved the agreement and directed the Trustees to report to the Court, by December 11, 1972, their recommendations for further action in the event the efforts of the Standing Committee do not result in a settlement of the dispute.

The Interim Agreement will reduce operating expenses for 1972 by approximately $1.0 million. (On an annual basis, reduction of 285 trainman positions would lower operating expenses by approximately $4.2 million at current contract rates.) As of September 22, 138 crews have been designated to operate with a conductor and one brakeman pursuant to the July 21 Agreement. Collective bargaining by the Standing Committee with regard to the final solution of the crew consist issue is continuing.

The Trustees are also able to report that except in Indiana there are now no state "full crew" laws imposing unnecessary employees on Penn Central. The Indiana law was amended early this year to permit reduction of crews in that state to the size provided for in collectively bargained agreements, subject to review and approval by the Indiana Public Service Commission. Hearings before the Indiana Commission are now in progress. If the Commission approves, the law will permit without further negotiation the reduction by attrition of one trainman from trains which heretofore were required to be operated in that state with three trainmen. This would result in an annual saving, at current rates, of approximately $4.1 million. In addition, the Massachusetts Department of Public Utilities has modified its regulations to permit the reduction of one brakeman from crews designated for such reduction under the Interim Agreement of July 21, 1972 between the Trustees and the United Transportation Union.

A further comment is appropriate. While there has been progress, each of the agreements mentioned above, and each of the recently amended "full crew" laws, permits reduction from prior requirements only by attrition. As a result, unnecessary employees will continue in service for many years. An increase in traffic would, of course, absorb some otherwise unnecessary employees. However, the program for reduction of uneconomic freight lines will create even more unnecessary employees, most of whom must, under present labor contracts, be continued in employment until death, resignation or other separation from service. The figures stated at page 1, above, in connection with the proposed freight system, indicate the magnitude of the latter problem. Those figures, however, include only the costs attributable to retention, until reduced by attrition, of employees rendered unnecessary by reductions in the size of the system. The costs of employees who are unnecessary whatever the size of the system, but who can be reduced only by attrition, are not separately identified but are included in "railway operating expenses" in Exhibit II of Annex 1.

Finally, it should be added that reductions in nonoperating employees continue, although in some aspects of the Company's business the limit has been reached. Total employment, which was 95,772 as of June 1970, and had been reduced to 82,818 on June 15, 1972, has been reduced to 82,328 as of August 15, 1972.

III
PASSENGER DEFICITS

The Trustees continue to believe that, while Penn Central desires to provide passenger transportation service and is able and willing to do so, continued passenger services must produce enough revenue to cover their full costs. Implementation of that policy requires cost studies, particularly in the Boston — Washington corridor. That corridor is primarily a passenger railroad, with freight activity being conducted alongside Amtrak intercity passenger traffic and local commuter traffic. Since passenger traffic is not a marginal activity, the avoidable-cost approach to subsidy, which presupposes that passenger traffic is a marginal activity, is inappropriate.

A study of the corridor, including the line from Philadelphia to Harrisburg, is being made by De Leuw Cather & Company and Haskins & Sells, and separate studies of the Philadelphia and Boston commutation service are being made by Klauder Associates.

These studies, basically completed during September but undergoing further refinement, will form the basis of negotiations with Amtrak and various local commuter authorities in the northeastern corridor.

The Trustees and Penn Central management have invited Amtrak and the various commuter authorities to assist in evaluating and refining the results of the cost studies. The Trustees believe that Amtrak and local commuter authorities should have ample opportunity to analyze their approach and take positions in regard thereto in the remaining months of 1972. In their January 1, 1973 Report, the Trustees should be able to state whether the responses provide a satisfactory answer to the passenger aspect of the obstacles preventing viability of the Penn Central.

In the meantime, some progress has been made. The problems concerning Amtrak rights with respect to former Boston & Providence properties to be sold to the Commonwealth of Massachusetts, which had held up that sale, have been resolved. Currently taking place are discussions concerning possible public acquisition of the Penn Station passenger complex in New York City and the rehabilitation of the Newark passenger station. Recent meetings with officials of New Jersey concerning full cost reimbursement or takeover of various northern New Jersey commuter lines have been encouraging. Discussions with Southeastern Pennsylvania Transportation Authority concerning possible SEPTA takeover of facilities used in the Philadelphia — SEPTA commuter service are also proceeding. Discussions with respect to commuter services in the Chicago, Detroit and Baltimore-Washington areas are being initiated.

IV
TRAFFIC VOLUME AND REVENUE

The Trustees' July 1, 1972 report referred to "a steadily growing volume of profitable freight business" as an indispensable foundation for a private-income-based reorganization and described the results through May of 1972 as "inconclusive". It added that "by the end of the year (1972) the Trustees should be able to report as to whether this essential element (of an income-based reorganization) can be realized or not."

Three months later the results, while still far from conclusive, appear to demonstrate an upward trend along the lines forecast in the Trustees' report of April 1. Carloadings, after lagging 1971 for seven months of 1972, were 6.8% ahead in the month of August. September is showing even greater gains over 1971, and the latest forecasts by Temple Barker & Sloane and Penn Central Management indicate that the railroad will experience a traffic increase of 3% to 5% for the full year.

Freight revenues are ahead of those in 1971, principally because of rate increases and an improved commodity mix favoring higher-rated commodities. Assuming that traffic continues to build in the fourth quarter as forecast, freight revenues for the full year should show a 4% to 7% improvement over 1971.

It should be noted, however, that these current forecasts of both traffic and revenues fall below the levels forecast in the Five-Year Base Plan study filed with the Court on February 24, 1972. The differentials in the original and current forecasts are primarily

explained by two developments. The reduced levels of freight tonnage and revenues are traceable to three commodities or commodity groups — coal, iron ore, and iron and steel. In addition, the recent hurricane and floods and strikes (including strike threats) affected freight tonnages and revenues adversely, causing the following losses during the period through August:

	Tons	Revenues
Flood Loss	1,100,000	$8,200,000
Strike Loss	500,000	$4,000,000
	1,650,000	$12,200,000

Looking beyond 1972, the upward business trend so crucial to an income-based reorganization is not so firmly established that the Trustees can feel fully confident that present growth in traffic and revenues will continue unabated. The revenue level originally projected for the 1972—1976 period for coal, a mainstay commodity for Penn Central, has been revised downward because of anticipated slackening in the use of high-sulphur coal.

The Trustees continue, however, to see evidence of offsetting gains in many other commodities, some of them highly rated. In the first thirty-seven weeks of 1972, Penn Central increased its share of Eastern District traffic by 3% over the same period one year ago. In respect of some commodities, Penn Central has shown increases over 1971 (and in certain cases, over the forecast) during the first 8 months of the current year.

	Est. 1972 (tons)	Reported 1971 (tons)	
Stone, Clay & Glass Prods	7,200,000	7,084,000	+ 1.6
Autos & Parts	7,460,000	7,182,000	+ 3.9
Grain	3,900,000	2,682,000	+ 45.4
Grain Products	4,980,000	4,968,000	+ 0.2
Misc. Food Products	7,510,000	7,499,000	+ 0.1
Lumber & Wood Products	4,610,000	4,133,000	+ 11.5
Pulp & Paper	9,300,000	8,750,000	+ 6.3
Chemical & Allied Products	11,000,000	10,662,000	+ 3.2
Petroleum Products	2,000,000	1,871,000	+ 6.9
Forwarder-Shipper Assoc.	1,700,000	1,518,000	+ 12.0

In addition, the prospects for solid growth in piggyback service constitute Penn Central's best hope for sustained overall increases in volume. So far this year piggyback traffic is up 18 percent over 1971. Within the last month, Penn Central has been authorized by the Interstate Commerce Commission to publish round-trip rates on solid 30-car (60 trailers) piggyback trains between New York and Chicago, and service began on September 15. So far the demand is heavy and increasing.

Piggyback is the area where, as previously reported to the Court, there is an enormous potential for gain in transferring trailers presently on the highway to lower-cost transportation by rail. Penn Central's rates must reflect this cost advantage and, even more important, its service must continually improve.

V
OTHER REORGANIZATION MATTERS

Taxes. The Trustees had earlier hoped to recommend to the Court a program for partial resumption of payment of state and local taxes in the last quarter of this year. Cash flow problems, notably those wrought by the recent hurricane and floods, have thus far frustrated this objective.

The Trustees remain nonetheless concerned about the impact, upon the other claimants against the estate as well as upon taxing bodies, of continued deferral of taxes. They are presently exploring a variety of avenues which would permit them to tender partial tax payments at the earliest feasible time. If cash flow permits, their program will not await their January 1, 1973 interim report; at all events, developments in this area will be separately reported on in each of the Trustees' future submissions to the Court on the status of the reorganization.

Claims. Following a hearing on August 28, 1972, the Court approved certain future steps in the Proof of Claims program. The Court has now ordered that —

(a) a claimant who files a proof of claim or amendment thereto after the applicable deadline is to be excluded from consideration or participation in any plan of reorganization except where the claimant affirmatively demonstrates to the Court good cause for exemption from the deadlines;

(b) claimants (other than dividend claimants) who were previously omitted from the proofs of claim program are to be given further notice of the requirement of filing proofs of claim and a period of 60 days within which to file;

(c) dividend claimants, most of whom the Trustees cannot locate, are to be exempted from the requirement of filing proofs of claim;

(d) the Trustees are to investigate and report on the claims of each claimant; each claimant is to be afforded an opportunity to establish his entitlement to any amount (or status, or priority) not acknowledged by the Trustees; continuing differences are to be resolved by settlement or liquidation by the Court or a special master, and interested claimants are to be given an opportunity to object to the resolution of the claims of other claimants;

(e) there is to be established, for the coordination of the many activities involved in the proofs of claim program, a Proofs of Claim Office, Office of the Trustees, Penn Central Transportation Company, 15 North 32nd Street, Philadelphia, Pennsylvania 19104, along with an Administrator thereof; and

(f) the Administrator of the Proofs of Claim Office is to maintain a public claims register containing the essential terms of the liquidation of the claims of each claimant as such liquidation occurs, and is to report to the Court monthly on the status of the liquidation of pre-bankruptcy claims.

Leased lines. Progress continues toward resolution of the difficult problems posed by the need to adopt or reject leases of various lines of railroad.

A petition has been filed seeking authority to adopt the lease of the Erie & Kalamazoo Railroad. The lessor has filed an answer consenting to such adoption.

The hearing on the petition to comply with the agreement to operate the Peoria & Eastern Railroad has been postponed due to the uncertainties surrounding the Debtor's cash position in the aftermath of the recent hurricane and floods, but will be rescheduled as soon as possible.

The Interstate Commerce Commission has affirmed the decision of Division 3 granting the application of the Providence & Worcester Company for a certificate authorizing the P&W to commence independent operation of its line of railroad, and the P&W has filed with the Court the notice required under Order No. 170 stating its intention to retake its property and commence operation in accordance with the order and certificate of the Commission. The Court has extended the stay imposed by Order No. 170 until October 13, 1972, to afford the Trustees time to decide on any further steps which may be appropriate with respect to the P&W.

The decision by the Court on the agreement to settle the PCI loan matter, described in earlier reports of the Trustees, and now pending before the Court, will remove some of the uncertainties with respect to the leases of Penndel Co. and The Philadelphia, Baltimore & Washington Railroad Company. A Court decision on the settlement with pledgees of Pennsylvania Company stock will likewise remove some of the uncertainties with respect to several leases.

The studies which bear on decisions whether to adopt or reject various leases are proceeding as scheduled. As already reported, the study of the costs of providing passenger service in the northeast corridor has been substantially completed, and Wyer, Dick & Co., having completed its viability study, is now turning its attention to the allocation of projected earnings to leased lines and other segments included in the 15,000-mile system proposed for reorganization. Completion of these studies will greatly aid in deciding whether to adopt or reject particular leases.

A method of allocating system revenues and expenses among leased lines and other segments of the Debtor's system has been proposed and is being tested for reliability. For reasons of economy and practicability, initial application of the system will be limited to leased lines. The new record keeping required is scheduled to be placed in effect as of January 1, 1973, and the formula for allocating revenues and expenses will be completed and ready for application to the results of operations in the first quarter of 1973.

The situations of the leased lines not discussed herein, and of the Pennsylvania-Reading Seashore Lines, have not changed materially since the Trustees' July 1, 1972 Report. The Trustees believe, for the reasons set forth here and in their prior reports on executory contracts and leased lines, that prudent action is not yet possible with respect to those leases and agreements as to which no petition to adopt or reject has been filed. They recommend, therefore, that the Court extend until further order the Trustees' time to adopt or reject those leases and agreements, provided that the Trustees will include a further report thereon in their report due January 1, 1973.

VI
ALTERNATIVES TO AN INCOME-BASED REORGANIZATION

In their July 1, 1972 Report, the Trustees, while noting the progress which had been made toward achieving a conventional private-income-based reorganization, recognized that a range of alternatives should be formulated in case future developments force the Trustees to the conclusion that such a reorganization is not possible. This is not a position of pessimism but one of prudence so that the Court, the public and all interested parties may begin to consider the alternatives. The Trustees will be doing likewise during the coming months, and will welcome further suggestions.

At the risk of stating the obvious, the alternatives to a private-income-based reorganization are by no means limited to complete government ownership and operation — nationalization — or cessation of service — liquidation. In between are a wide variety of possibilities, and an even wider variety of combinations of such possibilities. What follows, therefore, in the first part of this section are basic elements of alternative plans based upon public assistance. These include those that involve public funds or credit, and those that do not. A second part illustrates how some of these elements could be combined in a plan of reorganization.

The Trustees have reached no conclusion, even tentative, on the most desirable alternative. Their evaluation continues and will be obviously benefited by responses to this submission. They will continue to evaluate the elements and combinations of elements.

1. Elements of Alternative Plans

A. Assistance Involving Public Funds

Public assistance could be used to support operating costs, or to supply capital needs. In the former category are:

1. *"Need" subsidy.* Such a subsidy would make up any short-fall between income and expenses, including some reasonable compensation to claimants against the bankrupt estate. Analogies are the manner in which the Federal Government supports local service private-enterprise airlines, what foreign governments do when they pick up the "bottom line deficit" of their nationalized carriers, and essentially the way in which, until recently, the United States Postal Service was supported. The amount of the subsidy may also be on some type of formula set in advance, such as the Class Subsidy Rates for local airlines or the Index Subsidy for shipping, which is designed to build in an incentive for efficiency.

2. *"Ad hoc" subsidy.* This is paid for specified purposes, services or objectives. Such a subsidy might be paid either for maintaining a particular line or for carrying certain types of traffic. In the former category would fall a subsidy for maintaining service over some of the lines excluded from the system which the Trustees have selected, but which are deemed essential, or branch lines which state or local governments or shippers wish to continue in operation. In the latter category would be a subsidy for handling recyclable material at non-compensatory rates or for encouraging export trade. Canada has used subsidies of the latter sort for certain rates on export grain, and for maintaining rail service in the Maritime Provinces. In many countries a considerable portion of passenger service is operated at a loss and is subsidized in such a way.

3. *"Unloading" relief.* A variant of "ad hoc" subsidy is what may be called "unloading" relief — taking over from the railroad various activities which it has been required to perform at a loss. The financial consequences are similar, but in "unloading" relief, as distinguished from "ad hoc" relief, the railroad is no longer in a position of primary responsibility; some governmental or quasi-governmental agency is interposed. The obvious examples are Amtrak and urban transit authorities, but the pattern could be extended — for example, to grade crossing elimination, maintenance of overpasses and bridges by state highway authorities, public ownership and operation of branch or secondary mileage. "Unloading," in a somewhat special sense, would also include abatement of all real estate taxes on railroad right-of-way (many states already abate such taxes) and on some or all yard facilities. Any such "unloading" would doubtless require a sharing of the tax burden by the Federal Government, since many local taxing authorities are now heavily dependent on railroad real estate taxes. "Unloading" would also include an assumption by the Federal Government of all or a part of the costs involved in reduction of the labor force — the labor protection liability which is now involved in the present guarantee of a lifetime job for most of the railroad's employees. Such assistance could be either a one-time payment (if the claims were liquidated through negotiation on a lump-sum basis) or as a diminishing payment over a period of 10—15 years.

4. *Segregation of "corridor" railroad.* One particular form of "ad hoc" subsidy requires a more elaborate explanation. The northeastern corridor from Boston to Washington has important characteristics quite different from those of the rest of the system. As is suggested elsewhere, the general inability of passenger service to be supported from the fare box, plus the huge capital costs and substantial additional maintenance of way and signaling expenditures associated with present and future high-speed corridor passenger service will require heavy public support of as much as two-thirds of the corridor's activities. Given present inadequate divisions, the cost of operating major East Coast freight terminals and the cost of dovetailing corridor freight service with the high volume of priority passenger service, corridor freight service would probably continue to be less profitable than that on the remainder of the Penn Central system. Despite its financial problems, however, the northeastern corridor is clearly essential in the national and regional interest for both economic and environmental reasons.

The rest of the Penn Central system is primarily a freight railroad with relatively marginal intercity passenger service and commuter service. Although under present conditions the rest of the system loses money as a whole, it can be made self-supporting with much less difficulty than the corridor.

The foregoing considerations suggest that the operating property and facilities of the northeastern corridor could be segregated from the balance of the railroad by conveying them to a separate corporation or otherwise, in order that public funds could be directed

toward this portion of the system in any of the variety of ways stated in this Report. Participation in such subsidies by state and local agencies as well as by the Federal Government might well be anticipated.

In the category of public assistance in meeting capital costs are the following:

5. *Acquisition of right-of-way.* Partial government ownership rather than complete nationalization could be achieved by government purchase of the railroad's right-of-way, with a provision for the railroad's use of the line. The purchase could be of the entire right-of-way or only a part of it; it could be of all railroads or only of those in the part of the country where present railroad bankruptcies are concentrated. The acquisition could be limited to the underlying right-of-way, or could include improvements and auxiliary plant facilities such as freight terminals. The essential feature is a governmental taking over the costs associated with the basic "right-of-way," as is the case, in one way or another, with highways, waterways and airways.

6. *Car supply.* Government assistance in providing freight cars is another possibility. The perennial shortage of cars at the right place at the right time, compounded by the present strong trend toward special or specially equipped cars that move under load in only one direction, has prompted a variety of proposals for government assistance — by way of cheaper or more available credit or even a publicly owned freight car fleet. A correlative approach would be government funds to develop and install a computerized car control system on a nationwide basis, since improvement in freight car utilization would have the same effect as adding more cars to the nation's fleet.

7. *Loans and guarantees.* Loans or loan guarantees offer a different means of assistance. The United States has already guaranteed a loan to the Trustees from private investors of $100 million. Loans and loan guarantees were the devices used by the Reconstruction Finance Corporation when a third of the railroad mileage of the United States was in bankruptcy. They are being proposed as a basis for some relief from the costs of repairing the damage caused by the recent hurricane and floods. Loans or guarantees might also be made available for the purpose of retiring existing debt and claims at less than face value, with the consequent reduction of fixed charges and, doubtless, of litigation in the bankruptcy proceeding.

B. Assistance Not Involving Public Funds

The possibilities involving no government funds, now to be discussed, are nonetheless primarily within the power of government to grant, or require the active cooperation of government and other parties, such as other railroads.

1. *Equitable relief.* There are a number of areas in which some legislative action could correct inequities. The Congress appears to be willing to move, for example, against local taxes which discriminate against railroad property. In only one of these areas, however, would there be a prospect of material improvement for Penn Central — legislation designed to permit a prompt resolution of the inequity resulting from the present division of rates between the southern and certain western railroads, on the one hand, and the eastern railroads, including Penn Central, on the other. Present Interstate Commerce Commission procedures and practices result in inordinate delays, and delay itself is one of the inequities. Penn Central has already urged a partial remedy in addition to present court remedies — that any change in divisions be made retroactive to the commencement of the ICC proceeding in order to reduce the incentive to prolong the proceeding. Legislation might also direct a prompt Commission decision, with retroactivity to the date of the legislation, and with an appropriation of the extra funds needed by the Commission to make promptness possible.

2. *Segregation of non-rail assets.* The Trustees' Plan for Reorganization of April 1, 1972 presupposes that substantial benefits from the development or sale of Penn Central non-operating real property would accrue to the reorganized railroad. (The discussion in this section excludes Pennsylvania Company properties, which would be disposed of.) Under the Plan, the lien of New System Mortgage Bonds is limited to operating property; this would make it possible to form a separate real estate subsidiary of the reorganized

company which could maximize the development potential of these properties. If a private-income-based reorganization is attained, the benefits from real estate rents, sales or development could provide a valuable cushion protecting the long-term viability of the reorganized railroad under cyclical changes in the economy.

The Real Estate Reorganization Board created by the Trustees in July has identified 338 parcels of non-operating real estate at various locations scattered over the Penn Central system with a probable individual value of more than $100,000 each, and with an aggregate value in the range of $600,000,000 to $650,000,000.

This total, which includes seven mid-Manhattan properties under contract of sale subject to Court approval, comprises income-producing properties already developed to their highest and best use; other properties yielding less than optimum income pending redevelopment planned or in progress; abandoned yard and terminal facilities producing little income but suitable for development over time; and vacant parcels whose location is valuable in relation to the plans of other developers.

The current cash flow from the income-producing properties is between $25 and $30 million annually before property taxes. State and local taxes on these properties are currently running at the rate of $12.5 million a year. Redevelopment of properties might cause property taxes to rise, but any such increase should be modest in relation to the attendant enhancement in values and in cash flow.

Kuhn, Loeb & Co. and Jackson-Cross Co., financial and real estate consultants to the Trustees, believe that a real estate entity formed to hold, manage, develop and — where appropriate — sell Penn Central non-operating properties would be financially viable.

An alternative, therefore, is such a separation of the non-operating real estate from the railroad. The proposed real estate company could be a wholly owned subsidiary of the railroad, or it might be less than wholly owned, with a portion of the equity securities distributed to claimants or made available on appropriate terms to unaffiliated interests such as co-venturers in development projects. In the opinion of Kuhn, Loeb & Co., real estate placed in a separate company would produce substantially greater values in new senior and junior securities for distribution to claimants than would obtain without such a separation. Furthermore, if a purely private-income-based reorganization is not feasible, the additional values created by separation of non-rail assets could make a substantial contribution towards satisfying the claims against Penn Central. To the extent this is done, the public contribution required for the railroad from government agencies or shippers would be reduced.

The Trustees have reviewed current sales under consideration as well as the proposed disposition of their stock interest in Pennco in the light of this possible alternative. Since litigation is pending or may be brought in connection with those transactions, it is appropriate only to comment that the Trustees find no inconsistencies.

3. *Eastern railroad restructuring.* That most eastern railroad mileage is now in bankruptcy necessarily suggests that the problems to be solved are regional and that a regional approach — a restructuring of the entire eastern railroad system — would be an alternative, perhaps requiring a quasi-government corporation with opportunity for private participation.

4. *Sales to others.* One alternative short of outright liquidation would be the sale of all or of some Penn Central lines, appropriately grouped, to any prospective purchaser offering a reasonable price. Lines for which no such purchaser came forward would be dealt with under other alternatives.

2. Possible Combinations

As already indicated, the elements or alternatives can be combined in a variety of ways. The three combinations which follow are stated generally and only for purposes of illustration.

A. *"Intermediate" Mileage.* As already noted, there is considerable mileage in the present Penn Central system which falls in what may be described as an intermediate category. This is mileage which produces net operating losses but which cannot be

eliminated without also producing, in the short term, labor protection costs even greater than the present losses. Some of this mileage could well be deemed "essential" in any governmental evaluation of "essential railroad mileage," and some of it might well not qualify for abandonment under the current abandonment standards of the Commission.

A combination of elements could permit Penn Central to take advantage of the greater net operating income potential of the smaller system. A subsidy might be provided by the Federal Government for those portions of this intermediate mileage deemed essential, in whatever amount was necessary to bring the contribution of that mileage up to the level of the remainder of the system. If revenues on a portion increased, the subsidy would decrease or terminate entirely. Alternatively, such essential mileage could be acquired by the government outright. In either event, this mileage would continue to be operated, and the labor protection costs which would result from its abandonment would be avoided.

Whatever part of the "intermediate" mileage was neither subsidized nor acquired would be abandoned, and the Federal Government would undertake to assume the resulting labor protection costs. A combination of federal and state or local funds to achieve all this could be worked out. This combination of elements could of course be combined with other forms of relief, which would reduce the amounts necessary for subsidy. This combination could also provide for a reexamination by the Federal Government at periodic intervals to determine whether particular intermediate mileage being subsidized should be purchased or abandoned. It is likely that the same combination of elements could be used in a coordinated way for all bankrupt eastern railroads.

B. *"Corridor" acquisition.* The separation of the northeast corridor portion of the present Penn Central system referred to at pages 9—10 could be combined with government acquisiton of the right-of-way and fixed plant in that corridor. Much of the mileage in the northeast corridor is now primarily used by Amtrak or one of the urban transit authorities or both, and thus is already devoted to non-commercial, quasi-governmental use. The viability of the remainder of the present Penn Central system would be enhanced if the corridor burdens were entirely eliminated. Freight operations in the corridor would be preserved and paid for.

This alternative could be combined with the alternative mentioned in the preceding section A.

C. *Three entities.* A still further package would combine the separation of the northeastern corridor and the separation of the non-operating real estate described at pages 10—11. This would result in three components: the northeast corridor rail system, the balance of the rail system, and the non-operating real estate. As already indicated, the rail system in the northeast corridor would be subsidized. The remaining privately owned rail system would be able to stand on its own feet, or could be enabled to do so by some of the alternatives already noted. The real estate component, as a separate entity, would provide a substantial amount for the claimants against the bankrupt estate, reducing the amount of compensation required from other sources.

CONCLUSION

Many interests in this reorganization, especially those involved with creditors' rights, have expressed impatience at the progress made towards attaining the prerequisites of a successful reorganization. Many also have interpreted the Trustees' willingness to develop and explore alternatives to a conventional plan as an expression of doubt that a successful reorganization can be achieved.

Such reactions are not surprising, but in view of the magnitude of the problems, the Trustees believe their approach is the correct one. As noted in the Trustees Preliminary Report of February 10, 1971, "the conditions to Penn Central's viability are hard and introduce factors that go far beyond the normal boundaries of a railroad reorganization proceeding under Section 77." In the main, the Trustees consider progress to date satisfactory.

Further, the exploration of alternatives cannot be considered as any indication of a retreat from the Trustees' unequivocal preference for a reorganization within private enterprise. Nor can it be interpreted as a lack of confidence in the feasibility of such a reorganization. Creative government involvement has always figured in the Trustees' plans. Again, as early as their February 10, 1971 Report, the Trustees noted that an overriding problem of Penn Central is its "obligation to perform as a public service company in certain areas and under certain conditions which simply do not lend themselves to profitable operations, no matter who the operator is, or how efficient. The only possible remedy here is for public authority to lend its hand to a speedy elimination of the conditions which produce the losses, or respond with adequate compensation if it insists upon a continuance of the conditions."

Finally, whatever the precise form the plan of reorganization finally takes, it will be based upon a continuation of the bulk of the railroad's services. Penn Central is simply too important in the national transportation system for any other result seriously to be considered. For that reason, steps taken in the interim to improve the railroad's plant and service can only serve to enhance its value, for the benefit of its owners no less than for the public good.

Respectfully submitted,

GEORGE P. BAKER, RICHARD C. BOND, JERVIS LANGDON, JR. AND WILLARD WIRTZ, TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR.

By /s/ Jervis Langdon, Jr.
One of the Trustees

/s/ Robert W. Blanchette
Robert W. Blanchette
Counsel for Trustees

/s/ Covington & Burling
Covington & Burling
Special Counsel for Trustees

Dated: October 2, 1972

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ANNEX 1

WYER, DICK & CO.
TRANSPORTATION CONSULTANTS

VIABILITY STUDIES
PENN CENTRAL TRANSPORTATION COMPANY
September 25, 1972

Prepared by Wyer, Dick & Co.
Newark, New Jersey

I. DESCRIPTION OF STUDIES

At the request of the Trustees we have studied the potential viability of Penn Central freight rail networks of approximately 11,000 and 15,000 road miles in size.

The 11,000 mile system consists of major through routes and known high-density feeder lines. The 15,000 mile system is the railroad that results after abandonment of approximately 5,000 route miles which are included in the present Penn Central abandonment program.

The detailed parameters of each network studied are shown in Exhibit I, attached, and are portrayed on the accompanying map. It should be clearly understood that the systems represented on the map are hypothetical and were established for study purposes only. External forces, such as hurricane Agnes and the normal management decision process, preclude this map's being used beyond its described purpose.

In brief, it was assumed that the 11,000 mile system came into being instantaneously at midnight on December 31, 1971. For comparative purposes, a similar assumption was made with respect to the 15,000 mile system. Finally, the 15,000 mile network was achieved by gradual reduction, in steps that gave effect to various phases of the abandonment program through the year 1975, so that the ultimate configuration existed for the entire year 1976.

The studies assign revenue to each segment based on an analysis of actual origins and destinations, plus an evaluation of traffic which otherwise might be lost through abandonment to determine that which might be retained through alternate origins and destinations.

Operating costs were assigned by a formula which reflected the size of the road, the volume of operations and anticipated density of traffic.

A sophisticated computer Model represented the lines to be studied and was used to accumulate revenue and related transportation units.

The base year for the studies was 1971 and the traffic and revenue projections made by Temple, Barker & Sloane were applied to produce results for the years 1973 to 1976, inclusive.

The results, thus attained, include: estimated cost escalation, gains in productivity, and crew manning assumptions based on current labor agreements and negotiations.

The studies also include estimates of non-recurring expenditures to stabilize maintenance levels and to provide for the cost of labor protection.

It should be understood that the rail networks described above are not comparable to any existing railroad, particularly in the territory served by Penn Central. The 11,000 mile road to a great degree, and the 15,000 mile road to a lesser degree, represent a new type of transportation system consisting of main lines and high density feeder lines. The concept requires scattered shippers not located in highly industrialized areas to come to the railroad rather than having the railroad come to them. The economic burden of passenger service is assumed to be borne elsewhere; and the ability to abandon lines which do not fit the concept is a *sine qua non*. Finally, rationalization of labor's "rights" and the railroads "needs" is considered as achievable.

II. SUMMARY OF RESULTS

The results of the several studies (shown in detail in Exhibit II) are summarized in the table below:

	NET RAILWAY OPERATING INCOME (In Millions of Dollars)			
System	1973	1974	1975	1976
11,000 MILES	(131.9)	(55.4)	31.3	102.7
15,000 MILES	(51.6)	33.8	130.8	212.4
15,000 MILES — IN STEPS	(67.6)	26.6	120.4	212.4

( ) — Denotes Deficit

III. ASSUMPTIONS

The following assumptions were made:

1. Each rail network will handle freight only and passenger operations will not constitute a burden in any way. This assumption goes beyond the concept that passenger service is self-sustaining; it assumes, in essence, that the passenger service does not exist.
2. The allocation of revenues and costs between freight and passenger services, shown in the Form A Report to the Interstate Commerce Commission for the year 1971, was used as a base for all studies. If other studies now in progress substantiate different allocations, modifications can be made to reflect these changes.
3. The studies are based on 1971 revenues and unit costs except for specifically described adjustments for improvements in efficiency and labor productivity which reflect either changes already put into effect at the time the study was made or future changes which are believed to be reasonable and obtainable.

   Adjustments were made to 1971 revenues and traffic levels to reflect increased tonnage, change in traffic mix and change in rate levels as projected by Temple, Barker & Sloane, Inc.

   Adjustments were made to 1971 costs to reflect:
   a. Higher average gross tons per locomotive unit on main line and primary feeder lines where daily service is involved.
   b. Greater average number of cars per train obtainable on a higher density railroad.
   c. Reduced number of car handlings reflecting the continuing trend of greater use of assigned equipment.
   d. Reduced number of intermediate switches per loaded car handled due to higher ratio of through traffic and empty car blocking efficiencies.
   e. Improved car utilization to reflect improvements already achieved.
   f. Increased average net tons per carload due to the continuing trend toward increased average car capacity.
   g. Increased labor productivity reflecting historic trends and the effects of continuing capital expenditures.
   h. Estimated savings from implementation of the current labor agreements and negotiations relating to crew manning.
   i. Normalization of maintenance costs.
4. Appropriate factors were applied to operating expenses, rents and taxes, to provide for the escalation of costs in the years 1973 through 1976.

IV. DESCRIPTION OF COMPUTER MODEL

The Rail Freight Model is designed to facilitate evaluation of the effect of various alternatives in rail freight plant and/or operations. It is a hypothesis-testing model, combining management judgment and computer analysis to maximize operating income.

The Model is comprised of data describing the system under study, and a series of programs to operate on the data. The data include:

1. A numeric description of the rail network.
   The network is represented as an ensemble of nodes and segments, with pertinent characteristics assigned to each node and segment.
2. A numeric description of the traffic handled by the system during a base period.

   The traffic is represented by records describing the revenue, carloads, and net tonnage for each type of traffic between each origin-destination pair.

Processing is performed in three major steps:

1. Routing of Traffic.
   A route is developed for each origin-destination pair, in accordance with a transportation policy specified for the run. Classification yards are identified for each route.
2. Traffic Analysis.
   The loaded car movements are accumulated by segments and nodes, and procedures are applied to develop other characteristics such as empty car, locomotive and train densities, gross tonnages, and fuel consumption. Totals are generated by segment, node, yard, and for the system. Additionally, the network may be divided into regions, and region summaries produced.
3. Cost Analysis.
   Application of appropriate cost factors to the data developed in the traffic analysis produces the operating cost. Cost summaries are prepared by ICC account code.

V. ESTIMATED REVENUES

1. Bases of Estimates.

Revenue estimates were based on an analysis of the summarized Freight Revenue Accounting (FRA) tapes for the year 1971. Revenue movements were sorted by origin and destination and revenues for each movement where both the origin and destination were on the road being studied were accumulated. For this purpose a junction-on was considered to be an origin and a junction-off was considered to be a destination. At the same time that the revenues were collected, traffic was sorted into basic commodity groups to permit projection of the future and better analysis of potential traffic retention.

2. Traffic Retention Studies.

In preparation for this study, Traffic Department field representatives were furnished with maps and descriptions of networks being studied and were asked to evaluate the possibility of retaining traffic originating or terminating on lines in their district which were proposed to be abandoned. These estimates were reviewed and in some instances revised by department officials and were used as a basis for judgments with respect to individual moves.

All off-line traffic movements were printed out and were individually examined by a special team with traffic and operating experience. This team used the prior evaluations, referred to above, to determine what portion of the traffic might be retained through new origin, destination or junction stations. In each case the mileage and revenues were revised to reflect the changed movement.

Overall retention ranged from 21% to 25.8% of the gross revenues that had previously been excluded.

3. Method of Revenue Statement.

Since the FRA tape records gross revenues, it was necessary to equate such revenues to Account 101, which is the level reported to the Interstate Commerce Commission. The

difference is accounted for by absorptions, adjustments, etc. The 1971 actual relationship of 95.38% was used.

4. Projections of Future Traffic Levels.

Future traffic levels were projected on the basis of the report made by TBS and reflected changes in traffic mix as well as total projected tonnage for the years 1973 through 1976. TBS estimates were expressed in terms of percentage changes which were then applied by major commodities to the base year traffic handled on the several roads, including traffic retention.

5. Projections of Future Rate Levels.

Future rate levels and therefore the amount of total freight revenue were projected on the same basis used by TBS in their report. It was assumed that rate levels would increase sufficiently to absorb most of the projected cost escalation for each year over and above that portion absorbed by improvements in productivity. The assumed absorption was 90% in 1973, 92% in 1974, 95% in 1975 and 97% in 1976. Such absorption was assumed to be at the rate of 50% in the first year following and full recovery in the second year following.

6. Other Revenues.

Joint facility Debits and Credits (Accounts 151 and 152) were adjusted to reflect a point by point analysis to determine what joint facilities would be on the several networks.

The remaining revenue accounts making up total freight revenues, i.e.: Mail (Account 106), Express (Account 107), Switching (Account 110), Water Transfers (Account 113), Storage-Freight (Account 135), Demurrage (Account 137), Rents (Account 142) and Miscellaneous (Account 143) were expressed as a ratio to Account 101 in the base year for each of the study networks and were assumed to remain unchanged through 1976 since these accounts are not normally affected by general freight rate increases.

VI. ESTIMATED OPERATING COSTS

1. Description of Costing Procedures.

The costing procedures in essence involved the assignment of a portion of the total freight expense shown in Penn Central's Annual Report Form A to the Interstate Commerce Commission for the year 1971 to each of the systems studied to reflect the effect of anticipated changes in size of the plant, traffic volume, methods of operation and resulting traffic density.

In order to approximate reality and to reflect the changes outlined above, the primary accounts were separated into special study groupings with the accounts in each group having a homogeneity which demands like treatment and analysis.

2. Key Sub Studies requiring separate handling are the following:

Organizational Analysis

The accounts in this study, which have to do with supervision, management and traffic, are not considered to be variable with moderate increases or decreases in traffic. Their size is established by the overall size of the plant to be supervised and by management philosophy.

Studies were made to establish the organization management and supervision necessary to operate the basic networks. In so doing, the management philosophy of Penn Central was adopted.

Normalized Maintenance of Way

Maintenance of Way expenditures for road and track accounts only have been normalized. Such expenses vary from year to year, and the actual requirements in any one year depend in large measure upon the amount of material applied in previous years in relation to the volume of traffic handled. The actual expenditures in any given period are affected by weather, by the appropriate cycle of maintenance for a particular element of property and by economic factors.

Normal or average annual maintenance represents the average expenditures required over the years to maintain the property efficiently and takes into account the estimated life of the various elements over their full life cycle.

Stabilization of maintenance levels was handled in a separate study which will be discussed later.

Joint Facility Analysis

Joint facilities were analyzed on a location basis to establish which joint facilities were on each of the networks.

Valuation Study Analysis

A special analysis was made of the previously completed valuation studies to permit the apportionment of certain maintenance of way accounts on a location basis. Since detailed maintenance data were not available by location, it was assumed that the maintenance on and off the networks being studied was in proportion to valuation.

Management Center Location Analysis

This analysis was used to place such expenses as drawbridge operation and operating floating equipment on a location basis.

Distribution of Overheads

Items of this type, such as stationery and printing, are not directly variable with traffic but are affected by other accounts which may be either fixed or variable. They were allocated in proportion to such accounts as a group.

Operations Model

The operations model as described in IV above produced operating units such as car miles, unit miles, yard engine hours, train miles, etc. Costs for each of the systems for those accounts which are 100% variable with such operating units were computed, based on the relationship to the base year. For example, yard operating expenses vary with yard engine hours.

VII. ESTIMATED RENTS & TAXES

Equipment rents were initially developed for each of the roads studied by applying use factors to the equipment and equipment costs that existed in 1971. Subsequently, the Penn Central Director of Planning Coordination made a revised equipment acquisition forecast which resulted in the adjusted net rents shown in Exhibit II.

State and local taxes are presently represented by order of magnitude estimates based on preliminary results.

VIII. COST ESCALATION

Cost escalation factors were developed for these studies on the same basis that was used for the Base Plan Study. A combined cost escalation factor covering wages, fringes, materials, rents, and taxes was applied to total operating expenses including rents and taxes.

IX. MAINTENANCE STABILIZATION STUDY

A study was made to determine the expenditures (above normalized) necessary to place the physical plant facilities in an adequate condition to handle traffic with a minimum of interruptions from derailments and slow orders. This study was conducted in the following manner:

1. Track Structure.

   An analysis of expenditures and material installations over a 17 year period was made and these figures were compared to reasonable expected service life of materials and certain conclusions were drawn. Spot field checks were made in order to check the accuracy of the conclusions.

2. Depreciable Accounts.
   Study was made from an analysis of expenditures over a 17 year period and general spot field checking to arrive upon certain conclusions.
3. Maintenance of Roadway Machinery.
   Comparison was made of the increase in capital account to the rate of maintenance expense in order to arrive at a conclusion as to whether machinery is receiving adequate maintenance.
   It was assumed that the required work could be performed over a period of eight years.

X. LABOR PROTECTION

Estimates of the cost of labor protection were based on the assumption that the work force could only be reduced by attrition.

For train and engine crews an attrition rate of 5% was applied by the Penn Central Labor Relations Department and their conclusions were adopted for this study.

Attrition for all other employees was taken at 60% of 5% or an effective rate of 3% to reflect the difficulty of filling jobs vacated by attrition with available and qualified employees.

Labor protection cost estimates, including fringe benefits and payroll taxes, are set forth below:

	1973	1974	1975	1976
	(millions of dollars)			
11,000 MILES	$190.9	$193.0	$193.7	$196.5
15,000 MILES	33.1	28.9	23.8	20.0
15,000 MILES in steps	16.0	19.5	18.8	20.0

Labor protection cost is defined as the cost of continued employment, reduced only by attrition, of those employees who would be made unnecessary because of reduction of the existing system to the 11,000 and 15,000 mile systems, respectively. Labor protection cost, as thus defined, does not include the cost of excess trainmen on crews to be retained. That cost is included in railway operating expenses.

EXHIBIT I
Sheet 1 of 3

VIABILITY STUDIES

PARAMETERS

11,000 MILES

	1973	1974	1975	1976
Route Miles	10,568	10,568	10,568	10,568
Track Miles	25,907	25,907	25,907	25,907
Car Loads (000)	4,667	4,757	4,848	4,936
Car Miles (000,000)	2,890	2,955	3,022	3,086
Net Ton Miles (000,000)	75,586	77,824	80,125	82,371
Gross Ton Miles (000,000)	160,666	165,089	169,693	174,152
Train Miles (C00)	42,616	43,145	43,893	44,368
Unit Miles (000)	107,406	109,803	112,376	114,240
Yard Engine Hours (000)	6,165	6,267	6,367	6,462
Employees	59,148	56,994	54,858	52,626

WYER, DICK & CO.
TRANSPORTATION CONSULTANTS

EXHIBIT I
Sheet 2 of 3

VIABILITY STUDIES

PARAMETERS

15,000 MILES

	1973	1974	1975	1976
Route Miles	14,984	14,984	14,984	14,984
Track Miles	32,221	32,221	32,221	32,221
Car Loads (000)	5,268	5,367	5,467	5,563
Car Miles (000,000)	3,231	3,300	3,372	3,441
Net Ton Miles (000,000)	85,497	87,981	90,527	93,009
Gross Ton Miles (000,000)	179,939	184,744	189,723	194,538
Train Miles (000)	49,583	50,135	50,925	51,426
Unit Miles (000)	121,038	123,581	126,294	128,260
Yard Engine Hours (000)	7,110	7,227	7,342	7,450
Employees	69,313	67,629	65,932	64,129

WYER, DICK & CO.
TRANSPORTATION CONSULTANTS

EXHIBIT I
Sheet 3 of 3

VIABILITY STUDIES

PARAMETERS

15,000 MILES IN STEPS

	1973	1974	1975	1976
Route Miles	18,478	16,566	15,534	14,984
Track Miles	36,520	34,118	32,980	32,221
Car Loads (000)	5,392	5,440	5,479	5,563
Car Miles (000,000)	3,299	3,341	3,381	3,441
Net Ton Miles (000,000)	87,309	89,083	90,740	93,009
Gross Ton Miles (000,000)	183,614	186,956	190,201	194,538
Train Miles (000)	51,835	51,317	51,234	51,426
Unit Miles (000)	124,510	125,570	126,697	128,260
Yard Engine Hours (000)	7,328	7,360	7,388	7,450
Employees	72,107	69,095	66,511	64,129

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EXHIBIT II
Sheet 1 of 3

VIABILITY STUDIES

INCOME ACCOUNT
(Estimated Current Dollars)
(In Millions)

11,000 MILES

Acct. No.		1973	1974	1975	1976
(501)	Railway Operating Revenue	1618.5	1740.2	1862.4	1971.1
(531)	Railway Operating Expenses	1272.8	1295.3	1313.3	1328.7
	Labor Protection Costs	171.8	173.7	174.3	176.9
	Net Revenue from Ry. Operations	173.9	271.2	374.8	465.5
(532)	Railway Tax Accruals	117.1	117.4	118.1	119.8
	Railway Operating Income	56.8	153.8	256.7	345.7
	Net Rents	188.7	209.2	225.4	243.0
	Net Railway Operating Income	(131.9)	(55.4)	31.3	102.7

( ) - Denotes Deficit

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EXHIBIT II
Sheet 2 of 3

VIABILITY STUDIES

INCOME ACCOUNT
(Estimated Current Dollars)
(In Millions)

15,000 MILES

Acct. No.		1973	1974	1975	1976
(501)	Railway Operating Revenue	1808.5	1946.0	2084.7	2208.9
(531)	Railway Operating Expenses	1471.7	1506.6	1536.6	1565.0
	Labor Protection Costs	29.8	26.0	21.4	18.0
	Net Revenue from Ry. Operations	307.0	413.4	526.7	625.9
(532)	Railway Tax Accruals	115.2	116.8	117.9	123.5
	Railway Operating Income	191.8	296.6	408.8	502.4
	Net Rents	243.4	262.8	278.0	290.0
	Net Railway Operating Income	(51.6)	33.8	130.8	212.4

( ) - Denotes Deficit

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EXHIBIT II
Sheet 3 of 3

VIABILITY STUDIES

INCOME ACCOUNT
(Estimated Current Dollars)
(In Millions)

15,000 MILES - IN STEPS

Acct. No.		1973	1974	1975	1976
(501)	Railway Operating Revenue	1849.1	1971.4	2089.9	2208.9
(531)	Railway Operating Expenses	1528.1	1537.6	1549.9	1565.0
	Labor Protection Costs	14.4	17.5	18.8	18.0
	Net Revenue from Ry. Operations	306.6	416.3	521.2	625.9
(532)	Railway Tax Accruals	119.6	119.7	121.0	123.5
	Railway Operating Income	187.0	296.6	400.2	502.4
	Net Rents	254.6	270.0	279.8	290.0
	Net Railway Operating Income	(67.6)	26.6	120.4	212.4

( ) - Denotes Deficit

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TRANSPORTATION CONSULTANTS

Annex 2
Page 1 of 3

PENN CENTRAL TRANSPORTATION COMPANY
Pro Forma Income Statements
Based on Viability Studies (a)

11,000 Miles

(Dollars in Millions)

	1973	1974	1975	1976
Net Railway Operating Income - Freight Service (b)	$(131.9)	$(55.4)	$31.3	$102.7
Net Railway Operating Income - Passenger Service	(c)	(c)	(c)	(c)
Trustees Administrative Expenses	6.5	6.5	6.5	6.5
Sub Total	(138.4)	(61.9)	24.8	96.2
Non-Operating Income Less Miscellaneous Deductions	36.9	36.9	36.9	36.9
Income Available for Fixed Charges	$(101.5)	$(25.0)	$61.7	$133.1

(a) Excludes impact of property retirements or sales of lines outside system studied. Also excludes profit from major sales of non-operating property.

(b) Includes deduction of the following items:

	1973	1974	1975	1976
Depreciation of property used in freight service - road	$19.7	$19.7	$19.7	$19.7
- equipment	45.5	47.0	47.2	47.8
State and local taxes on property used in freight service	46.6	48.2	49.7	51.2
Lease rentals for freight service equipment	90.1	94.6	97.7	100.0

(c) Assumed to be sufficient to cover return on capital investment in passenger service.

KUHN , LOEB & CO.

Annex 2
Page 2 of 3

PENN CENTRAL TRANSPORTATION COMPANY
Pro Forma Income Statements
Based on Viability Studies (a)

15,000 Miles

(Dollars in Millions)

	1973	1974	1975	1976
Net Railway Operating Income - Freight Service (b)	$(51.6)	$33.8	$130.8	$212.4
Net Railway Operating Income - Passenger Service	(c)	(c)	(c)	(c)
Trustees Administrative Expenses	6.5	6.5	6.5	6.5
Sub Total	(58.1)	27.3	124.3	205.9
Non-Operating Income Less Miscellaneous Deductions	36.9	36.9	36.9	36.9
Income Available for Fixed Charges	$(21.2)	$64.2	$161.2	$242.8

(a) Excludes impact of property retirements or sales of lines outside system studied. Also excludes profit from major sales of non-operating property.

(b) Includes deduction of the following items:

	1973	1974	1975	1976
Depreciation of property used in freight service - road	$23.0	$23.0	$23.0	$23.1
- equipment	52.7	53.6	54.3	55.0
State and local taxes on property used in freight service	53.1	55.1	55.1	58.5
Lease rentals for freight service equipment	94.1	104.1	110.8	116.8

(c) Assumed to be sufficient to cover return on capital investment in passenger service.

KUHN, LOEB & CO.

Annex 2
Page 3 of 3

PENN CENTRAL TRANSPORTATION COMPANY
Pro Forma Income Statements
Based on Viability Studies (a)

15,000 Miles - In Steps

(Dollars in Millions)

	1973	1974	1975	1976
Net Railway Operating Income - Freight Service (b)	$(67.6)	$26.6	$120.4	$212.4
Net Railway Operating Income - Passenger Service	(c)	(c)	(c)	(c)
Trustees Administrative Expenses	6.5	6.5	6.5	6.5
Sub Total	(74.1)	20.1	113.9	205.9
Non-Operating Income Less Miscellaneous Deductions	36.9	36.9	36.9	36.9
Income Available for Fixed Charges	$(37.2)	$57.0	$150.8	$242.8

(a) Excludes impact of property retirements or sales of lines outside system studied. Also excludes profit from major sales of non-operating property.

(b) Includes deduction of the following items:

	1973	1974	1975	1976
Depreciation of property used in freight service - road	$24.2	$23.6	$23.2	$23.1
- equipment	54.2	54.6	54.6	53.9
State and local taxes on property used in freight service	53.1	55.1	55.1	58.5
Lease rentals for freight service equipment	94.1	104.1	110.8	116.8

(c) Assumed to be sufficient to cover return on capital investment in passenger service.

KUHN, LOEB & CO.

Exhibit 56

January 4, 1961.

J. D. M.: Perhaps you have not seen the statement of July 12th, prepared by the Director of Taxation, showing the effect of removing one mile of track on our property taxes.

Note that the abandonment of track in any state in which we operate increases our taxes in Maryland. On the other hand, the abandonment of track in Maryland proposes a savings 2 to 4 times that obtained in any other state, even if the land is retained—and only a nominal increase in taxes occurs in New Jersey with no increase in other states.

This statement vigorously demonstrates the need to eliminate as much track as is possible within the State of Maryland. Are you satisfied that your Region, within the State of Maryland, has been thoroughly and carefully analyzed in order to determine the maximum amount of track that can be abandoned? If not, such action should be taken immediately.

Please advise.

J. P. N.

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Exhibit 57

File 073. Tax savings to be derived from abandonment of all necessary tracks and/or facilities.

Tax Savings

Savings in state and local taxes are uncertain and cannot be predicted. Because State and local governments are constantly in need of new and additional revenue, lower taxes that might have been expected from actions we have taken in the past, are not being realized. Administrative rulings, revised assessment formulae, and increased tax rates have wiped out the prospective reductions even where the property tax base has been diminished by abandonment. It is also a fact that track abandonments in one state that might generate tax savings there, would so increase taxes in other states as to result in an overall tax increase. Further, it must be noted that changes in income have a direct effect on the property tax valuation of two-thirds of our line. Increased income that must be expected from our program could result in increased state and local taxes.

AVPOP—February 20, 1970.

Philadelphia, *November 24, 1969.*

R. G. Flannery (1740): The attached study of the effect on our over-all taxes of abandonments in different states should be of interest and of value in appraising the savings as a result of proposed abandonments.

It is startling to note that as a result of abandonment of line in one state, we can substantially increase our taxes in numerous other states.

H. Large.

Penn Central,
Philadelphia, October 21, 1968

Mr. D. E. Smucker: In spite of the fact that we would like to get tracks off the tax rolls in New Jersey and to get cash in the treasury the work of taking up tracks on the New Jersey Division is proceeding at a snails pace.

I asked the people on the trip last week to arrange to sell to scrap dealers much of the yard tracks which are in place so that we can get the cash this year and get the tracks off the tax rolls.

Will you please follow up on this matter.

A. E. Perlman.

October 23, 1963.

Mr. Saunders: This refers to discussion on our recent inspection trip with respect to the effect of track abandonments on State and local taxes in the various States in which we operate.

I am attaching hereto an interesting statement on the subject, prepared by our tax people at my request several years ago. Mr. Warner tells me that, while the figures are necessarily based on a number of arbitrary assumptions, they are still generally valid.

It will be noted that abandoning track in the State of Delaware not only increases taxes in that State, but in Maryland and New Jersey as well—with an over all adverse effect systemwise.

While track abandonments in other States have the effect of increasing taxes in Maryland and New Jersey, the net effects are nevertheless favorable in all States except Delaware and Pennsylvania. Actually, the adverse effect in Pennsylvania (when land is retained) is on the assumption that the underlying property ceases to enjoy its tax-free status as operating property and is placed on the tax list as other than operating property. In actual practice, however, this does not occur when one of two or more tracks is abandoned—only when a single track is abandoned.

A. J. G.

EXHIBIT 58

OCTOBER 13, 1970.

J. R. SULLIVAN: It appears from the Third Quarter 1970 Branch Line Abandonment Program report that Mr. Musslewhite's and my letters to you and your letter to Mr. Kreyling have no effect on the Vice President—Operation's office as only two lines totalling 5.1 miles were removed from the list of "ICC Petitions Being Prepared" while 41 lines totalling 698.6 miles were added to this list, none of which we have been consulted on. One of these lines has even proceeded to the point where a hearing was held last month. In addition, none of the lines to which objections were raised have had any change made in their status. Further, one petition has been filed which according to the Second Quarter report hadn't even reached the "Under Study" level.

While we, and I am sure you, appreciate being consulted on abandonment matters, we would feel somewhat better if we weren't merely wasting time and paper by replying.

T. B. GRAVES, Jr.

EXHIBIT 59

J. R. SULLIVAN—1534: This is in response to your request for memorandum on the Master Abandonment Program covering over 6,000 miles of our line currently underway on the Penn Central.

I am strongly of the view that this program is wrong in conception and impetus. The 6,000-mile-plus total figure was arrived at over a year ago with minimal consultation with the various interested departments. It is proceeding at an active pace with the only planning that is visible to us being in the desire to abandon as much trackage as possible. This may not be so, but the lack of comprehensive analysis, particularly on the present and potential earning aspects, give rise to a recommendation that the whole Branch Line Abandonment policy be reviewed by top management with an idea to establishing guidelines that will optimize our probable corporate result. It would seem reasonable that analysis of branch line abandonment should include consideration of the following factors:

1. The relationship between the money invested in the branch, its present or potential ability to earn revenue, and the possible actual net salvage money (not bookkeeping figures) which would result from abandonment. This is important since if there is any reasonable probability of future traffic, the relatively small amount of reclaimable capital compared to the capital represented by a line of railroad still intact is almost certainly unimportant relative to the incremental value of additional revenue, provided this possibility exists at all.

2. If there is present revenue, the *actual* expenses of the branch must be subtracted and the estimated contribution of this traffic to the rest of the railroad must be evaluated and its amount of contribution dollarized.

3. If there is a favorable balance from this procedure, the branch is profitable from a short-range marginal standpoint until such time as unusual expenses or new capital are required to keep it in operation. It should not be abandoned until that time, or until the traffic mix changes adversely.

4. If the overall out-of-pocket expenses of the branch, plus the estimated expense of carrying the freight beyond, exceeds the total revenue for the branch, the branch is a *candidate* for eventual abandonment. At this point, Sales, Marketing, Coal & Ore, etc. should evaluate the potential of the branch and provide a set of figures upon which other departments could base possible abandonment studies.

5. If the gross revenue of the branch is less than the actual out-of-pocket expenses for running the branch, it is of course a priority target for abandonment, subject to any indication of a highly probable favorable change in revenue level or an impending reduction in the amount of expense.

6. In addition to evaluations currently being made as to net salvage, etc., any branch that serves as a link must be evaluated from the standpoint of our requirement to maintain existing routes and junctions. This evaluation should be made for the purpose of determining the alternative costs of handling the traffic via alternative routes.

7. In some circumstances, the effect of abandonment on the terms of leases, contractual arrangements with underlying companies, mortgages, etc. have to be considered. Proceeds from an abandonment that must be moved into the hands of a trustee for a mortgage rather than being made available for general railroad purposes requires a Financial Department decision as to the desirability of such a course.

8. Still to be reconciled is the effect of increasing circuity of mileage on our costs. As we have already pointed out, abandonments and other decisions resulting in circuitous movement are undertaken by the Operating Department supposedly to reduce costs below those existing over presently effective routes of movement. However, when translated by the Cost Department, they invariably increase our costs and show up in the guise of lessened profitability, lessened incentive for investment, inability to quote competitive rates, etc. This question has to be answered. It does not make sense to make operating decisions to cut costs that result in increased costs; and wherever the proposed abandonment involves a link in our present network, this problem is present.

The following comments are oriented toward the present procedure from a specific rather than a general point of view:

In order to effectively analyze and determine the possible side effects in actual operating mileages, routing, junctions, present and potential traffic flows, possible indicated rate adjustments, we require access to supporting papers for each abandonment project. We receive this material only on some projects at the present time.

In addition to the ordinary course of protest before regulatory bodies, there are often special circumstances such as those pertaining to the end of the Madison Branch (Item 8–34 of the current abandonment project). A few years ago, the City of Madison, Indiana, advanced funds to the former PRR to rehabilitate this line after a washout, bringing into question the feasibility of the abandonment and the probable financial outcome in the event of protest.

We note several inconsistencies in the current project report—such as Items 8–2 and 8–13. The first proposes to tear up one of two tracks on the former NYC's Indianapolis-Cincinnati Main Line which is "plagued with very unfavorable grades and tonnage freight trains use the route via Richmond, Ind." Item 8–13, however, suggests abandonment of the ex-PRR line between Richmond and Cincinnati which is now handling the same tonnage trains. The latter action would require extensive rebuilding of the Cincinnati Northern Branch between West Manchester and Carlisle Junction, Ohio, and necessitate detour of these trains in a more indirect manner. Such traffic would then add to the congestion of the already busy former NYC Main Line between Cincinnati and Middletown, which is also handling Cincinnati-Columbus trains rerouted from the old PRR C&X Branch now up for abandonment.

We do not have the resources within this Department to generate all of the material needed to make the type of study indicated by the criteria set forth above, which we believe to be the prudent abandonment procedure for the Penn Central, nor if we did is it likely that it would in all cases create acceptance of the recommendations so generated. We believe, however, that the importance of getting the abandonment program on the corporate "track" is fundamental to the future health of the Company.

George R. Wallace.

EXHIBIT 60

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In the Matter of	:	In Proceedings for the Reorganization of a Railroad
PENN CENTRAL TRANSPORTATION COMPANY,	:	
Debtor	:	No. 70–347

TRUSTEES' PLAN FOR REORGANIZATION

(April 1, 1972)

The Trustees file herewith their proposed Plan of Reorganization, Part I, with a schedule for filing the remaining provisions and comments on the present state of reorganization planning.

I.
Plan of Reorganization
PART I

1. *Statement of Conditions for Reorganization*

The conditions on which this Plan of Reorganization is based are as follows:

A. The Debtor will secure relief from the burden of continued employment of train service employees unnecessary for safe and efficient operation.

B. The Debtor will secure relief from the financial burden of operating freight service on uneconomic lines, many of which are identified on Attachments 2 and 3 with others to be identified by amendment to the Plan.

C. The Debtor will secure relief from the financial burden of operating all passenger service, both inter-city and commuter, for which it is not fully compensated.

D. The volume of freight traffic handled by the Debtor will increase substantially to the levels forecast by Temple, Barker & Sloane (TBS) in Attachment 4 adjusted to take into account the effect of the relief described in B above.

2. The effective date of the Plan will be January 30 of the year which follows a calendar year during which all administration claims other than Trustees' Certificates shall have been substantially discharged, and the Debtor shall have earned income available for fixed charges[1] not materially less than $275 million, provided further that reasonably anticipated income available for fixed charges in the year in which the reorganization is consummated and subsequent normal years is not less than $275 million.

3. If income available for fixed charges has not reached $275 million per year by the calendar year 1976, then this Plan shall be deemed withdrawn and alternative proposals will be made. If at any time it shall appear to the Trustees that the Debtor will not succeed in reaching such a level of earnings by 1976, they will promptly so inform the Court and the Interstate Commerce Commission (ICC).

4. On July 1, 1972, October 1, 1972 and January 1, 1973, the Trustees will file with the Court reports assessing progress towards realization of the Conditions for Reorganization and proposing any necessary reassessment of their reorganization planning. The July 1, 1972 Report will deal particularly with Condition A (surplus employees); the October 1, 1972 Report will deal particularly with Condition B (uneconomic freight lines); and the January 1, 1973 Report will deal particularly with Condition C (passenger service) and will report on further progress on uneconomic freight lines. A final report of the Trustees, to be filed on April 1, 1973, will, unless otherwise ordered by the Court, complete this Plan of Reorganization.

[1]As used in this plan, unless stated otherwise, income available for fixed charges is calculated after deduction of equipment leased rentals but before federal income taxes.

5. If the Court directs that the completed Plan be filed with the ICC, the ICC will schedule hearings to determine whether the conditions for reorganization have been or promptly will be accomplished in sufficient degree to make feasible this Plan of Reorganization. If the ICC finds in the negative, it will so report to the Court, which may then direct the prompt filing of another plan, including a plan for liquidation, or may dismiss the proceeding. If the ICC finds in the affirmative, it will promptly schedule further hearings on such other issues as may be raised with respect to the Plan.

6. Reorganization of the Debtor will be accomplished by cancellation of outstanding securities other than Trustees' Certificates and equipment debt, satisfaction of claims against the Debtor according to their priorities, and corporate simplification, all as hereinafter provided. Upon consummation, the Debtor will be discharged of all claims and liabilities as provided in Section 77.

7. As part of the Plan, the Debtor is authorized to abandon any uneconomic route miles of line, those identified on Attachments 2 and 3 and those to be identified by amendment to the Plan which by the effective date of the Plan (a) have not been abandoned, or (b) have not been made subject to arrangements relieving the Debtor of continuing losses. As conditions to abandonments effected by the Plan, the Debtor will be required (1) to maintain service on each line for six months following approval of the Plan by the ICC; (2) to sell the entire line or any part thereof to any purchaser offering within the six-month period no less than fair value and desiring to purchase the line for continued railroad use; (3) to continue the line in service for a contract period if any person or entity, within the six-month period, offers to execute a contract with the Debtor by which the Debtor contracts to operate specified freight service over such line in return for full compensation for the service contracted for. The Court will have reserved jurisdiction to determine, at the request of either the Debtor or any person or entity claiming to have made an offer hereunder, whether the offer is adequate.

8. As part of the Plan, the Debtor is authorized to terminate any passenger service for which it is not fully compensated. As a condition of such right to terminate, the Debtor will be required to continue to provide any passenger service for a contract period if any person or entity offers to execute a contract with the Debtor by which the Debtor contracts to operate the specified passenger service in return for full compensation for the service contracted for. The Court will have reserved jurisdiction to determine, at the request of either the Debtor or any person or entity claiming to have made an offer hereunder, whether the offer is adequate.

9. Upon reorganization, and provided that the Internal Revenue Service rules prior to the effective date of the Plan that income tax losses of the Debtor may be carried forward by the reorganized Debtor for the period provided in Section 172 of the Internal Revenue Code, the capital structure of the reorganized Debtor will consist of the following classes of securities:

(a) Trustees' Certificates.
(b) Equipment Obligations.
(c) New System Mortgage Bonds.
(d) New Common Stock.

New System Mortgage Bonds and New Common Stock of the reorganized Debtor will be distributed among those having interests in the Debtor's estate on a fair and equitable basis, as will be provided in the completed Plan. In addition, a portion of such securities may be issued in exchange for outstanding securities of the Debtor's subsidiaries (including leased lines) which may be merged into the reorganized Debtor.

(a) *Trustees' Certificates.* Trustees' Certificates previously issued are restricted as to prepayment by their terms and thus will remain, until paid, a lien on the assets of the reorganized Debtor prior to the New System Mortgage Bonds. $50 million of such Trustees' Certificates bearing interest at 6—1/8% will become due

in 1976, and the remaining $50 million bearing interest at 7.05% will become due in 1986 but are redeemable beginning in 1981.[2]

(b) *Equipment Obligations.* The amount of equipment to be retained and acquired by the reorganized Debtor, and thus the level of its equipment obligations, will be determined on the basis of the anticipated operating needs of the reorganized railroad. This determination will be affected by the size of the reorganized railroad and its level of traffic. In order to allow for the maximum amount of equipment which might be needed, it is presently assumed that the reorganized railroad will need as much equipment as the Debtor's management projects for the existing system operating at the increased level of traffic predicted for 1976 by TBS in Attachment 4.

On that basis, the outstanding amount of equipment obligations (equipment trust certificates and conditional sales agreement obligations) is projected at $436 million at the beginning of 1976. Interest on equipment obligations is projected at $35 million for 1976.

In addition, rentals payable under equipment leases are estimated at $132 million in 1976. Based on the formula presently approved by the ICC, one-third of such lease rentals, or about $44 million, would be considered as equivalent to interest for the purpose of calculating fixed charge coverage.

(c) *New System Mortgage Bonds.* The reorganized Debtor will convey to a mortgage trustee to secure New System Mortgage Bonds such of its real estate, track, bridges, tunnels, buildings and structures as are necessary for future railroad operations. The security conveyed by such mortgage will exclude air rights, mineral rights and such other subsurface rights as are not needed for railroad operations, and will also exclude both rolling stock and any other equipment and facilities for which separate financing is customarily available. Apart from the coverage of capital assets to be financed in whole or in part by subsequent issues of System Mortgage Bonds, the mortgage indenture will not have after-acquired property coverage provisions. All New System Mortgage Bonds issuable under the indenture will be entitled to a sinking fund calculated to retire them over a period not in excess of 25 years after issuance. In other respects, the New System Mortgage Bonds and the mortgage indenture will contain provisions customary in such documents, the precise provisions to be determined by the reorganization managers. New System Mortgage Bonds will be issuable as follows:

(i) The initial issue will be made at the time the Plan of Reorganization becomes effective. Most or all of the New System Mortgage Bonds will be issued to holders of pre-bankruptcy interests in the Debtor, but a portion may be issued to holders of outstanding securities of the Debtor's subsidiaries (including leased lines) which may be merged into the reorganized Debtor. A small amount may be issued for cash, to be applied to final settlement of unpaid administration claims. The aggregate amount of New System Mortgage Bonds initially issuable upon reorganization would be limited to an estimated $800 million. On the assumption that such bonds would bear interest at 7—1/2%, first-year interest charges on the initial New System Mortgage Bonds would be $60 million. The amount of New System Mortgage Bonds initially issuable will be adjusted if other provision in the nature of fixed charges is made for the holders of debt of merged subsidiaries assumed by the reorganized Debtor or for lessors of leased lines in cases where such leases are affirmed in the Plan and such lessor companies are not merged into the Debtor.

(ii) In addition to the foregoing, refunding bonds will be issuable to refund New System Mortgage Bonds, to refinance Trustees' Certificates at maturity or upon optional redemption if applicable, and to refinance maturing issues of subsidiary debt assumed upon merger into the reorganized Debtor.

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[2]Trustees' Certificates may be refinanced by New System Mortgage Bonds. See 9(c)(ii).

(iii) Additional bonds would also be issuable to finance railroad additions and betterments. The amount of bonds so issuable will be limited in order to protect the credit rating of the reorganized Debtor.

(iv) All series of New System Mortgage Bonds will share pro rata with earlier issues in the overall security provided by the New System Mortgage.

(d) *New Common Stock*. The reorganized Debtor will issue a single class of New Common Stock with an aggregate value of $1.4 billion.

10. Pending consummation of the Plan, cash not needed for railroad operations and capital expenditures will be applied, as the Court may from time to time direct, to the discharge of administration claims.

Further Provisions
Parts II, etc.

A. A report with respect to the size of, and specific lines on, the system to be reorganized will be filed by October 1, 1972.

B. Provisions relating to the treatment in the Plan of affiliated companies, including leased lines and operating subsidiaries, relating to classes of claimants and allocation among them of interests in the reorganized Debtor, and the mechanics of the Plan, such as execution, reorganization managers, etc., will be filed on April 1, 1973.

II.

Summary of Trustees' February 15
Report and Comments Thereon

On February 15, 1972, the Trustees filed, as directed by the Court, their Report on Prospects for Reorganization of the Debtor. The Trustees concluded that a successful reorganization is feasible dependent (in addition to maximum efforts of self-help by the Trustees and management), on increases in freight traffic and all-important relief, necessarily requiring the cooperation and efforts of others, to alleviate the burdens of (a) unnecessary employees, (b) operating freight service on lightly patronized, unprofitable lines, and (c) providing passenger service in return for less-than-adequate compensation.

The Trustees estimated on the basis of preliminary studies that if these conditions were substantially realized the Debtor might reasonably anticipate by 1976 income available for fixed charges within the range of $220 million to $290 million. They expressed their opinion that such a level of income will be adequate for an income-based reorganization provided such necessary relief becomes available quickly enough to stop and to reverse the accumulation of unpaid administration claims (and consequent erosion of the estate available for pre-bankruptcy interests) in the intervening years. As the most extreme alternative to such an income-based reorganization, the Trustees mentioned nationalization, which they opposed.

On February 24, 1972, the Trustees filed a further Report Filing Certain Studies in Connection With Reorganization Planning. This report made available, to the extent then possible, the studies on which the Trustees based their conclusions (a) that an income-based reorganization is not feasible without substantial realization of the conditions mentioned above, and (b) that with such realization, an income-based reorganization will be feasible.

Seventeen separate comments were filed on the Trustees' February 15 Report. Both the United States Department of Transportation (DOT) and the ICC say they agree with its basic conclusions, including the necessity for substantial realization of the basic conditions for reorganization, and indicate their willingness to assist in achievement of those conditions. DOT, however, takes issue with the Trustees' view that a constitutionally adequate income-based reorganization must produce values for pre-bankruptcy interests

which are "at least in a fair equivalence to the liquidation value of the estate" (February 15 Report, p. 12). The Department of Justice briefly takes issue with the Trustees' suggestion that nationalization of Penn Central in its present condition could "perpetuate the inefficiencies and inadequacies which the Trustees' proposals would eliminate" (February 15 Report, p. 13).

The ICC suggests that the Trustees should accelerate and strengthen their abandonment program, but questions, even if that is done, their estimate that the necessary streamlining can be accomplished "in substantial part" in 1972 and 1973. The Commission also expresses willingness to re-examine the labor protective conditions imposed in the Penn Central merger proceeding to determine whether they now appear "unduly burdensome."

The investor interests express considerable skepticism as to whether the needed relief can be realized substantially enough and soon enough to make feasible a reorganization along the lines proposed.[3] The investors generally criticize the studies and forecasts presented by the Trustees as probably too optimistic. (The ICC, on the other hand, regards the Five-Year Base Plan Study as "conservative.") The investors urge that more specific and detailed studies be submitted to include an identification of the lines which the Trustees plan to abandon, and seek additional information regarding the form of the proposed capitalization of the reorganized company and the specific governmental action which the Trustees require to achieve the relief they say they need. Some of the investors say the Trustees should accelerate the disposition of non-rail properties, but others contend that these assets should be retained and that the Debtor should somehow rid itself of the burden of railroad operations and reorganize essentially around its non-rail assets.

Some investors criticize the Trustees for making inadequate progress to date on realization of the conditions for reorganization. The Institutional Investors Penn Central Group proposes that the Trustees make periodic reports over the next year stating in detail what progress has been made, and propose April 1, 1973 for a final decision as to whether the progress realized makes it appropriate to continue efforts towards the type of reorganization proposed by the Trustees. Only two of the parties assert that it can now be determined that an income-based reorganization is not feasible.

Several of the investors ask that the Trustees be directed to report more fully on the alternatives to an income-based reorganization. But DOT believes that consideration of such alternatives would be premature at this time. Reuben R. Robertson, III, *et al.* make extended comments in support of the view that the nationalization alternative is worthy of more serious consideration.

This review does not purport to refer to all the important points and questions raised by the various pleadings, but merely summarizes those which the Trustees find particularly material to their reorganization planning.

III.

Progress Made in Definition and Achievement of the Conditions for Reorganization

The February 15 report did not detail the progress made to date in specific definition and achievement of the conditions for reorganization. The comments filed indicate that a further statement is appropriate.

The Trustees are fully aware that the viability (in the private enterprise system) of the rail form of transportation in the northeastern states (and ultimately in the entire country) is at stake in these proceedings. They believe that, given reasonable time and help from others, such viability will be established, and Penn Central will emerge as a strong carrier with sufficient earning power to operate with confidence in the future.

In the progress report that follows, the performance of the Trustees so far is set forth as well as their planning for the future. If this planning succeeds, as the Trustees are

[3]The Trustee of the New Haven goes so far as to suggest: "Even if an income plan could be devised which carried the hope of some interim success by 1976, the adverse characteristics of the Penn Central system service area, to which the Trustees themselves have previously adverted in detail, flash all the signs of the New Haven's own prior experience. The New Haven was 'successfully' reorganized in 1947 after a proceeding which began in 1938, only to become bankrupt again in 1961."

confident it will, the public and private interests in strong rail transportation in the northeastern region of the country will be served, and everyone will gain.

Freight Volume and Revenue Increases

To reorganize Penn Central, a primary condition precedent is an increase in freight revenues, supported by volume increases in the years to come.

The firm of TBS, consultants to the Trustees, have recently presented in definitive form their study forecasting the Debtor's freight traffic through 1976, and that study is filed as Attachment 4 hereto. The TBS forecast is incorporated in the revenue side of the income and expense projections for the years 1971—1976 which was Exhibit 1(b) to the Trustees' February 24 report. This forecast projects a 9 percent increase by 1976 over freight traffic moved in 1970. It forms the basis for the revenue ingredient of the preliminary figures used in Part D of the Freight Core Study (Exhibit 2, p. 8 to the February 24 report), which estimates income available for fixed charges at approximately $275 million with all the conditions for reorganization substantially realized. That projected income, in turn, forms the basis for the capital structure incorporated in the proposed Plan of Reorganization outlined herein.

The reasons why the Trustees believe that traffic increases of at least the order of magnitude projected by TBS are reasonable are as follows:

First. In the past 15 months the quality of Penn Central's freight service has improved to the point where it is generally regarded by the shipping public as first-class. One of the reasons for the precipitous and disporportionate decline in Penn Central's freight volume, particularly following the merger, was atrocious service which users of transportation avoided like the plague. In the future, Penn Central's presently good service will be made even better. This is bound to put more tonnage on the railroad and should allow Penn Central to grow with the economy instead of going downhill.

Second. In the past, also, competitive business was driven away by Penn Central's rigid pricing policy, which set the pattern for the other railroads in the east. From 1965 through June 1971 cumulative rate increases aggregating 39% (as compared with 18% to 24% increases in competing truck rates) were directly responsible for the loss by the eastern railroads of an estimated 100,000 trailers per year in piggyback service with the loss to the Penn Central amounting to an estimated 50,000 trailers. To attract new business, and to hold old business, the Trustees since January 1, 1971, have made more than 100 major individual rate adjustments (some of them reflecting new marketing techniques) on a variety of commodities including rock salt, grain, crude oil, soda ash, semi-finished steel, manufactured iron and steel, potatoes, cement, wall board, asbestos sheeting, wood pulp, alcoholic liquors, motor vehicles, auto parts, carbolic acid, sand, paper, sugar, magnesium, limestone, frozen citrus concentrates, buses, turbines, and piggyback traffic. The Trustees intend to pursue the course of improving Penn Central's competitive position by supporting its better service with realistic (and innovative) pricing. In countless instances, net earnings can be improved in this manner.

Third. Progress is also being made in the gradual elimination of traffic carried for less than cost. A detailed analysis of 1969 figures (the full details of which were submitted to the ICC for review at its request early last year) showed a loss from this source aggregating $80 million using long-term variable costs. On the basis of 1970 figures, a loss of $25 million was incurred on traffic which did not even earn its short-term variable costs, thus producing a cash drain.

Such losses must, of course, be eliminated. Certain rate increases have already become effective. A 25% increase in rates on cereal traffic (light-loading yet requiring high quality box cars) is an example. Other increases, opposed vigorously by consumer groups, have been suspended by the ICC, including increases in citrus rates from Arizona and California to the east, vegetable rates from the southwest, and increases in protective service charges. Further increases of rates, minimum weights, or charges for services on canned goods, household appliances, light loading papers and maximum absorptions for the loading and unloading of water-borne freight have been proposed by Penn Central and

are under consideration by the ICC. In the aggregate these increases should reduce the loss by several millions. General rate increases both in 1971 and again in 1972 are giving, and will give, further help.

The one area where skepticism is possibly justified is in the prospect for fairer and more realistic divisions of freight revenues. Non-compensatory divisions cannot be eliminated by Penn Central acting alone. Cooperation of connecting lines is required. If Penn Central received divisions on interterritorial traffic (between the east and the south and between the east and the west) in keeping with the standards set forth in the Interstate Commerce Act, its revenues would be sharply increased — by tens of millions of dollars annually.

Attainment of fairer divisions is, however, most difficult. The southern and western lines refuse to submit the issue to arbitration, and Penn Central has filed with the ICC a complaint against the southern lines. This course has led in the past to interminable litigation (which, based on the precedents, could consume 10—12 years). Penn Central requested the ICC to sponsor legislation which would expedite such litigation (by giving the ICC power to make its findings on divisions retroactive, and by confirming its power to set interim divisions subject to later adjustment and to participate actively in the litigation), but the ICC declined. The Trustees see little chance for an early settlement of these divisions disputes unless the suggested legislation could be enacted.

Fourth. If Penn Central's service area were outside the northeastern region, there would be little question as to its prospects for traffic growth. But even in New England and the North Atlantic States of New York, New Jersey, and Pennsylvania — where Penn Central has 47% of its mileage — the outlook is favorable if Penn Central, while holding its own with bulk and other traditional rail traffic, can penetrate that enormous transportation market which connects the great industrial centers — a market with hauls between 300 and 700 miles which is dominated by highway carriage. Penn Central, with much to learn in offering the right kind of service and pricing it correctly, has already begun the attempt to penetrate it. The objective is to furnish a cheaper "highway," and to persuade all of the different categories of highway freight users, including regulated motor carriers, to take full advantage of it. Upon the outcome of this undertaking may depend more than upon any other condition the long-term viability of Penn Central and the other railroads in the northeastern states. The Trustees are confident of ultimate success because the economics (to be significantly contributed to by the operation with 3-man crews) are with them and so are important aspects of the public interest.

The System to Be Reorganized

Some creditors have reacted to the abandonment program of the Trustees by suggesting that it is too large to be accomplished in the near future. A further explanation of the program is appropriate.

The Freight Core Study included with the February 24 Report was both preliminary and incomplete since it included only rough figures for total revenues and costs, and did not attempt to identify the lines included in the hypothetical core. This made detailed assessment and evaluation of the Trustees' proposal difficult. The Trustees are refining the Freight Core Study, both to identify lines to be included and to provide a basis for projecting operating and non-operating revenues and expenses for each year from 1972 to 1976. As stated in the February 15 report, this study identified approximately 11,000 route miles which incorporate origin and destination points between which traffic in 1970 produced about 80 percent of the railroad's freight operating revenues. Attachment 1 hereto is a map showing in detail the 11,000 route miles which were studied.[4]

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[4]The actual number of route miles on Attachment 1, is approximately 10,820. For convenience this Report shall continue to refer to an 11,000-mile core. This mileage does not include mileage separately operated by subsidiaries such as the Pittsburgh and Lake Erie Railroad.

In pointing to a hypothetical core of 11,000 route miles, the Trustees did *NOT* say that the remaining 9,000 miles in the 20,000 mile system should be abandoned. On the contrary, the Trustees were careful to point out that an 11,000-mile core "would not constitute a full-service system, taking all interests into account", and that studies of "larger cores" were under way. The 11,000 mile core — on the basis of the studies still going on — represents a system where the utilization of Penn Central's plant, equipment and personnel appears to peak. The Trustees are proceeding as rapidly as possible to identify those additional lines which will be added to the 11,000-mile core, without substantially dissipating the benefits to be realized from more efficient operations with higher density. The task is proving extremely complex, particularly as detailed consideration is given, as it must be, to practicalities of operation, future traffic potential and special characteristics of the various lines. The information presently available to the Trustees suggests that the emerging system may well be substantially larger than 11,000 route miles. Accordingly the map in Attachment 1 *must* be considered as a hypothesis for reorganization planning.

The detailed studies now under way of the probable operating and financial results of the 11,000-mile hypothetical system and of substantially larger systems are being carried out by Wyer, Dick & Company, consultants to the Trustees, with the cooperation and participation of several departments of the railroad. These studies are scheduled for completion by September 1, 1972. They will permit a decision by the Trustees as to the size of the system which should be proposed as a basis for reorganization.

Once that decision is made, the consultants and staff can analyze each leased line and mortgage segment of the Debtor's system to determine its prospective going-concern value on the basis of the system finally selected for the proposed reorganization. These studies are scheduled for completion by December 1, 1972. The result of these studies will be of critical importance to decisions on affirmance or disaffirmance of a number of leases and to the allocation among the various interests of securities of the reorganized company.

In rationalizing Penn Central's plant, the immediate concern of the Trustees is to eliminate the lines that are clear "losers" — lines which, in looking to the future, promise to hurt rather than help in the struggle for earning power.

Under a standard proposed by the ICC — but now under suspension as the result of a court order sought by railroad labor and the Commonwealth of Pennsylvania[5] — a total of 3,900 miles of line would qualify for abandonment because traffic is less than 34 cars per mile per year. Under a different standard of one million gross ton miles per mile of line per year, incorporated in legislation proposed by DOT, 7,000 route miles would qualify.

These results are based on past performance and cannot be regarded as dispositive. A line that is a "loser" today may be a "winner" tomorrow, or vice versa. Before the Trustees move on an abandonment, future prospects must be studied. The present planning of one of the nation's largest shippers could transform two Penn Central branches, now total losers, into important feeder lines; and other branches, also present losers, could spring into life overnight in serving new or relocated mining operations in the bituminous coal fields. In addition, the use of 3-man crews would have a profound effect upon the revenue-cost relationships of some of these marginal lines. On the other hand, there are factors (including continued inflation, if not offset and deferred maintenance), which could have an adverse impact.

It follows, then, that an abandonment program — a program that is an integral part of the rationalization of Penn Central's plant — is necessarily a continuing one. The

[5] Commonwealth of Pennsylvania, Pennsylvania Public Utility Commission, and Congress of Railway Unions v. United States of America and Interstate Commerce Commission, Civil Action No. 72—63, United States District Court, Middle District of Pennsylvania.

Trustees have now identified a total of 3,922 route miles (including the 1,345 miles already filed with the ICC, of which 492 miles have been approved for abandonment) which are clear, undisputed losers and should be abandoned as soon as possible. These 3,922 miles are identified on the map of the Debtor's system which is Attachment 2 hereto and are listed individually in Attachment 3.

Under the present ICC procedure, requiring a detailed application on each individual line, an average of ten applications per month have been filed averaging ten miles per application. The pace would have been faster had the Trustees not tried, in many instances, to compromise with the threatened opposition before filing and also had there not been legal problems concerning leased lines. The Trustees have had a special team at work on this project, which team is again being expanded and will be taken off all other duties. The Trustees' objective is to have all 3,922 miles of clear losers on file with the ICC at the earliest practicable date, with the bulk of the applications targeted for filing before the end of the year and the work completed in 1973.

In addition to these 3,922 miles, the Trustees believe that studies now in process will enable them to identify at least 1,600 miles of additional lines which will qualify for abandonment in 1974 and 1975.

Slow as the progress on abandonments appears to be so far, it threatens to become even slower if the 34-car rule referred to in the ICC comments is not implemented; the enactment of legislation now pending would also be of great assistance. The reason why the program will otherwise falter is that, in the applications already filed with the ICC, the Trustees started with the obvious abandonments — where the line was not in use and there was no real chance of any business in the future — and the ICC responded, in most instances, with prompt approval without hearing. But the Trustees quickly ran out of the "easy" cases and, when the applications to abandon lines still in use (although heavy losers) began to be filed, the pace slowed to a crawl. Nineteen such applications were assigned to the ICC's so-called modified procedure (involving an exchange of statements of fact and arguments by the parties but no public hearing), but the ICC has decided only 6 of these applications (and one of these is under reconsideration). In addition, five applications have been set for public hearing; in total, 52 applications are pending, including 34 without any indication as to further ICC procedure, including these important ones:

Filed	Termini (Originating or Terminating)	Mileage
3–31–71	Remsen-Lake Placid, N.Y.	118.4
3–31–71	Brocton-Blasdell, N.Y.	43.6
3–31–71	Oil City-Tidioute, Pa.	33.6
3–31–71	Chambersburg-Waynesboro, Pa.	19.1
8–26–71	Churubusco-Auburn Jct., Ind.	14.1
8–27–71	Waveland-Crawfordsville, Ind.	14.1
8–31–71	Clyde-Berwick, Ohio	21.1
10–15–71	Carthage-Greensburg, Ind.	27.8
10–18–71	Fredonia-Falconer, N.Y.	29.0
10–26–71	Newton Falls-Alliance, Ohio	17.4
	TOTAL	338.2

The ICC refers to the Trustees' program of abandonments as "a substantial program — one large enough to arouse forceful opposition." The Trustees are convinced that the program will move faster once the ICC's 34-car rule and pending legislation becomes effective.

Labor Conditions

At the time of bankruptcy Penn Central was burdened by "full crew" laws in three of its most important states: New York, Ohio, and Indiana. Since then, the New York law has been repealed, and similar action has been taken in Ohio. Earlier this year Indiana relaxed the binding effect of the "full crew" law in that state.

This is solid progress.

All that remains is for the collective bargaining process under the Railway Labor Act to work. More will be known about this in the next several months. In one of the creditor comments the Trustees are criticized for not specifying the legislation required to resolve their labor problems. Now that the "full crew" laws are gone or modified, federal pre-emption may no longer be necessary. Moreover, if the disputes over the employment of firemen and the consist of train crews can be resolved under the provisions of the Railway Labor Act, no legislation will be needed in respect to those issues.

Passenger Deficits

DOT "supports the Trustees' position that Penn Central should be *fully* reimbursed for the cost of providing passenger service, both intercity and commuter" (emphasis added), and the ICC points out that "as to any part (of the passenger service) that is not *fully* supported, it is...obvious that Penn Central cannot consistently provide the subsidy" (emphasis added). It is particularly encouraging that DOT should include in its comments that:

> "The Trustees' position relating to the basis of compensation for Amtrak passenger operations in the Boston-Washington corridor appears consistent with the principles upon which Amtrak was founded."

Accordingly, Penn Central's program for full compensation for passenger services is upheld by these government agencies, and both of them point out the procedures to be followed in bringing about such a result. The Trustees intend to follow their advice and to negotiate with the public bodies with a view to being relieved of these deficits.

IV.

Proposed Schedule for Completion of Reorganization Planning

The Trustees have submitted those portions of their actual Plan of Reorganization which can be articulated on the basis of the studies and other information presently in hand. A schedule for completing the remaining aspects of the Plan is also offered. That schedule incorporates, in the Trustees' judgment, the earliest dates at which those aspects of the Plan can be presented — simply because before those dates vitally necessary information will be lacking.

The Trustees continue to believe that the Plan suggested in their February 15 report and outlined here is feasible. They recognize, however, as the February 15 report emphasized, that its feasibility depends first on the degree of relief that will be forthcoming in the areas of critical concern. Secondly, it depends on the progress which the Trustees and management can make in further improving efficiencies and attracting more traffic to its system. Above all, feasibility depends on the speed with which these things can be accomplished. The Trustees accept the point, made by many of the investor interests, that specific, rapid and steady progress must be shown in these areas if the Trustees' Plan is not to be frustrated. The Trustees, therefore, propose on July 1, 1972, October 1, 1972, and January 1, 1973 to report on precisely what has been accomplished and what may then appear to be reasonably within reach of accomplishment, to reassess their reorganization planning as may be required by developments up to each date, and to report to the Court any alternatives suggested by required reassessments. They then propose to file a report with a completed Plan of Reorganization on April 1, 1973. The Trustees recommend that all parties be invited to comment on each report, and that this Court hold

hearings on any of them if it sees fit. If in the Trustees' judgment, or in that of the Court, less than adequate progress has been shown at any stage, the Trustees propose either to modify their Plan, if possible, or to discard it and to propose alternatives to an income-based reorganization.

Moreover, it seems both practicable and desirable that each report concentrate on particular aspects of the conditions for reorganization on which it is reasonable to expect that significant progress will have been made by the date in question. The Trustees therefore propose that, in addition to treating all developments of significance by the respective report dates, each periodic report be focused as follows:

The July 1, 1972 report will deal particularly with progress made towards elimination of unnecessary employee expense. As matters now stand, by July 1 the Trustees should be able to advise the Court whether acceptable progress has been or will be made on the crucial crew-consist issue.

The October 1, 1972 report will focus particularly on the Trustees' decision, made on the basis of studies which will be completed before that date, as to the specific lines to be included in the reorganized system which they propose, together with financial projections for operation of such a system through 1976.

The January 1, 1973 report will focus on progress towards achieving adequate compensation for passenger service, both inter-city and commuter, and on progress made and to be expected towards the realization of the restructured system which the Trustees will have proposed in October. Before that date, the Trustees will have presented their detailed proposals to Amtrak, and Amtrak should have decided whether or not to accept those proposals for inclusion in its forthcoming budget. Negotiations with several of the commuter entities should also be far enough along to permit an assessment of whether the condition for reoganization with respect to passenger service is reasonably possible or not. This schedule should also give adequate time both for an appraisal of the results of the accelerated abandonment program which the Trustees have undertaken and for a judgment as to whether the reaction of the ICC and other interested parties in this area makes further efforts along those lines worthwhile.

The April 1, 1973 report will complete the Plan of Reorganization by adding provisions regarding treatment of leased lines and operating subsidiaries, provisions relating to classes of claimants and allocation among them of interests in the reorganized Debtor, and other necessary provisions.

After the Plan has thus been completed, the Court would presumably hold hearings to determine whether the plan is sufficiently feasible to warrant submitting it to the ICC. In the event that either the Court or the ICC finds that the Plan is not feasible, the Court would reassess the situation in the light of that determination. The Court could conclude, depending on then-existing circumstances, to permit filing by the parties of alternative plans, either for reorganization or for liquidation, or it could dismiss the proceeding.

The projected schedule of dates for completing the details of the plan is realistic, since by the dates suggested the Trustees should have the information necessary for decision, and counsel will have time to prepare the appropriate portions of the Plan reflecting those decisions. The extended date for dealing with leased lines and operating subsidiaries reflects the complexity of isolating and evaluating segments of a system which until bankruptcy had not been considered as separate. The extended date for allocation of interests in the reorganized Debtor reflects both these same problems and similar problems in evaluating mortgage segments of the Debtor's system, as well as the need for further analysis and evaluation of claims generally.

Corporate Simplification

The Trustees believe that the corporate structure of the reorganized Debtor should be greatly simplified. It is presently contemplated that subsidiaries whose business activites relate to trucking, and other subsidiaries with businesses related or complementary to the Debtor's railroad, will retain a corporate existence separate from

that of the Debtor, unless on further investigation specific characteristics of individual companies or their operations make merger with the Debtor appear desirable. With respect to leased lines, proposed solutions for corporate simplification must await a decision on the size of the system to be reorganized. Only then can a meaningful analysis be made of the income-producing potential and other aspects of particular segments. Similarly, such analysis must await information which will be supplied by application of the segregated accounts formula now being prepared.

During the next twelve months, the Trustees expect not only to arrive at the decisions outlined above, but also to pursue matters concerning claims which must ultimately be settled and which may require litigation. Attachment 5 hereto is a report which describes the nature and amount of those claims which have been filed with the Trustees pursuant to the Court's order No. 164 and compares these claims with the Debtor's corresponding liabilities as shown on its books. The Trustees propose to file further reports in which they will describe each separate claim and state whether they object to it. The first such report will be filed not later than July 1, 1972.

V.
Explanation of Financial Provisions of the Plan

The Plan provides that reorganization will be consummated not earlier than the year after the first year in which the Debtor has achieved income available for fixed charges not materially less than $275 million, and assumes that prior to consummation enough cash will have been generated so that all real estate taxes and other administration claims other than Trustees' Certificates not then due and equipment obligations will have been discharged either by payment in full or by compromise. If future developments make it appropriate to reorganize when the income level is still materially below $275 million but that level is projected with reasonable certainty, the Plan could be amended accordingly.

Some explanation is necessary as to why the Trustees presently regard such a reorganization as reasonably capable of achievement, why the Trustees regard this particular level of income and accomplishment as a desirable goal, and what the Trustees presently think could be accomplished by reorganization on such a basis.

The sum of $275 million of annual income available for fixed charges by 1976 is within the range of the preliminary studies referred to in the Trustees' Report of February 15 and filed with this Court with their Report of February 24, if the Trustees promptly obtain the relief they believe necessary and if the percentage of overall traffic increase from 1970 to 1976 is within the general order of magnitude predicted by TBS. Achievement of the goal of discharge of all post-bankruptcy obligations during the reorganization period appears to the Trustees to be a function of cash flow improvement resulting from how soon the requested critical relief is obtained, the length of the period of reorganization, and how soon the level of the Debtor's freight traffic substantially improves. The Trustees cannot guarantee that it will be possible fully to discharge post-bankruptcy obligations during the reorganization period, any more than they can guarantee that $275 million in income available for fixed charges will be achieved at the end of the period. However, no information or analysis so far available to the Trustees convinces them that this cannot be done.

The Trustees recognize that the goal of discharging real estate taxes and administration claims during the reorganization period is an ambitious one. If the Debtor reaches a level of income available for fixed charges enough above $275 million to carry some unpaid real estate taxes and administration claims and still to achieve the purposes explained below, the Trustees would probably seek to consummate the reorganization without waiting for complete discharge of such obligations.

On the tentative assumption that the reorganized system will need as much equipment as the Debtor's management predicts for a system not substantially reduced in size, operating at levels of traffic predicted for 1976 by TBS in Attachment 4, the Debtor would require, on January 1, 1976, a freight equipment fleet comprising some 4,000

locomotives and 153,000 freight train cars. Assuming that one-third of the Debtor's freight cars are off line at any one time and that the Debtor continues normal usage of foreign cars and private cars, a total of 200,000 freight cars would be available to handle 1976 traffic. Approximately half of the Debtor's equipment owned by the reorganized Debtor would be subject to approximately $436 million in principal amount of equipment trust and conditional sale obligations as of December 31, 1975. For the year 1976, interest on equipment obligations is projected at $35 million. The Debtor's remaining freight equipment would be held under long-term leases for which annual rentals are projected at $132 million for the year 1976. Based on the formula presently approved by the ICC, $44 million of such lease rentals would be considered as equivalent to interest for the purpose of calculating fixed charge coverage.

The New System Mortgage Bonds proposed in the Plan reflect the confidence of the Trustees and the management in the future of Penn Central as a unified transportation system. The economic interests of the bondholders — as well as the stockholders — of the reorganized Debtor will be hinged to the success of the whole system rather than to the relative prospects of individual segments.

The amount of New System Mortgage Bonds initially issuable upon reorganization has been limited to approximately $800 million in order to provide a satisfactory credit rating for the debt obligations of the reorganized Debtor. Unless the reorganized Debtor can establish its credit in the eyes of the investing community, the New System Mortgage Bonds issued upon reorganization will trade at a discount from their full face value, and the new company would have difficulty arranging new long-term financing for its capital expenditures.

The interest rate of 7 1/2% assumed in the Plan for the initial issue of New System Mortgage Bonds will be reviewed in the light of changes in money market conditions and will be determined at a level designed to equate as closely as possible the face amount of such bonds to their market value at the time of issuance.

Based on the Plan outlined herein, fixed charges of the reorganized Debtor would be approximately $99 million in 1976, viz.:

	Principal Amount 1—1—76	Annual Interest
Trustees' Certificates	$ 50 million	$ 3.5 million
Equipment Obligations	436	35.1 (a)
New System Mortgage Bonds	800	60.0
Subtotal	$1286	$ 98.6
Interest component on leased rentals		44.0
Total fixed charges		$142.6

(a) This figure takes account of anticipated retirement and issuance of new obligations during 1976.

On the assumption that $275 million is available for fixed charges, such an amount would be about 2—3/4 times the interest charges of $98.6 million set forth above. However, it is necessary also to take account of the interest element in equipment lease rentals, which are treated in ICC accounting as an operating cost, before arriving at income

available for fixed charges. Applying the ICC formula approved for calculating fixed charge coverage, income available for fixed charges would be increased by $44 million (representing the interest element in equipment lease rentals) to $319 million, and fixed charges would be increased to $142.6 million.

Using the foregoing calculations, the reorganized Debtor would have a fixed-charge coverage ratio of 2.23 (319 ÷ 143) in 1976. Kuhn, Loeb & Co., financial advisers to the Trustees, consider that such a fixed-charge coverage ratio is acceptable for the purpose of a reorganization plan for the Debtor.

The recommendation by Kuhn, Loeb & Co. of a single class of New Common Stock for equity interests in the reorganized Debtor is made from the viewpoint of future financing flexibility. If the reorganized Debtor starts out with the simplest possible equity capital structure, it should be easier in the future to raise additional equity financing for the reorganized Debtor's railroad operations.

The value attributable to the common stock of the reorganized Debtor will be primarily dependent on earnings available for such common stock. On the basis of $275 million income available for fixed charges and $98.6 million fixed charges, net income before Federal income taxes would be approximately $176 million.

The Trustees have been advised that the Federal income tax loss carryforward under Section 172 of the Internal Revenue Code should be fully available to the reorganized Debtor, and in consequence significant Federal income taxes are not anticipated for several years following reorganization. Equity values in the reorganized Debtor would also take some account of undeveloped nonoperating real property interests retained by the Debtor or subsidiaries thereof. On these assumptions, Kuhn, Loeb & Co. considers it reasonable to project the creation of New Common Capital Stock on the basis of eight times earnings, or a total New Common stock issue of $1.4 billion.

Thus the total value of new securities issued by the reorganized Debtor — additional to Trustees' Certificates and equipment obligations — would be $2.2 billion on the foregoing assumptions.

The extent to which pre-bankruptcy interests in the Debtor's estate would be compensated by such a reorganization cannot yet be predicted with precision. As the Trustees' report on proof of claims (Attachment 5) indicates, much work must be done and many claims must be analyzed and adjudicated before a precise prediction can be made.

What can be accomplished by reorganization of the type presently proposed by the Trustees as their present goal and what are the consequences if this goal cannot be reached?

On the basis of presently available information, the Trustees note that the Plan of Reorganization proposed would provide compensation for pre-bankruptcy interests substantially in excess of what the Trustees believe they could have any certainty of obtaining in the event of dismissal of the proceedings and liquidation of the Debtor. From the standpoint of the public interest, if reorganization could be achieved on the proposed basis, the reorganized Debtor would be left in a strong financial position for sustained future railroad operations in bad times as well as in good.

Without now taking a position on the precise level of income necessary to support a constitutional reorganization, the Trustees emphasize that if achievement falls too far below the goals expressed in the Plan they presently propose, the Debtor could not constitutionally be reorganized on an income basis without substantial governmental financial aid.

In brief, the Trustees propose this Plan of Reorganization because (1) there appears to be a reasonable probability that it can be achieved if there is prompt progress in the direction of granting the relief outlined by the Trustees in their Report of February 15, (2) reorganization at such a level should largely avoid difficult and delay-producing constitutional issues, and (3) such a reorganization would leave the reorganized Debtor with the greatest financial and operating flexibility for the best future railroad service. If

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it later appears that the foregoing goals cannot be met, the Trustees will propose amendments to the Plan or will withdraw it.

VI.
Payment of Taxes

The Trustees are aware of the need to resume some payment of local real estate taxes as soon as their cash position permits.

The latest forecast indicates the likelihood of a partial resumption of tax payments by October 1, 1972. A petition requesting modification of Order No. 70 to permit this to be done will be filed. Further, the Trustees are currently exploring the possibility of combining the funds which they will have available from operations with proceeds from sale of assets to discharge or reduce existing tax claims.

Respectfully submitted,

/s/ George P. Baker

GEORGE P. BAKER

/s/ Richard C. Bond

RICHARD C. BOND

/s/ Jervis Langdon, Jr.

JERVIS LANGDON, JR.

/s/ Willard Wirtz

WILLARD WIRTZ

/s/ Robert W. Blanchette

ROBERT W. BLANCHETTE
COUNSEL FOR TRUSTEES

/s/ Covington & Burling

COVINGTON & BURLING
SPECIAL COUNSEL FOR TRUSTEES

Dated: April 1, 1972

* * * * * * *

EXHIBIT 61

PHILADELPHIA, *January 30, 1967.*

B. J. R.: As per discussion at the December 20th budget meeting, I have the following comments in connection with your advice dated December 30th, in regard to price variance, volume variance and market position:

PRICE VARIANCE

I fail to see where any practical value results from using the trend in revenue per ton and revenue per ton mile as a yardstick to measure revenue losses. For many years it has been necessary for competitive reasons to make many drastic rate adjustments in order to recover or retain traffic from other modes. Your conclusions ignore increase in length of haul and the revenue losses that would have taken place if the level of freight rates had been frozen.

In recent years, pricing officers, led by the Pennsylvania, have attempted wherever possible to adjust rates for competitive reasons on the incentive principle—i.e., a reduced rate for a heavier load and higher revenue per car; also volume rates and unit train rates. This program has been supported by the Operating and Financial Departments through the furnishing of higher-capacity cars with the result that average revenue per car and per car mile have increased substantially. As an example, while the decline in revenue per ton mile, between 1962 and 1965, produced a decrease of $39,852,000 in our revenues, the increase overall in revenue per car mile between these same years produced an increase of $35,090,000, and the increase of $11.15 in revenue per car produced an increase of $42,000,000.

VOLUME VARIANCE

No comment is necessary in connection with these figures, as your example is based on your price variance assumptions.

MARKET POSITION

Detailed comparisons of PRR originated, received and total traffic with that of our five major railroad competitors in the East are available quarterly. These are examined carefully by responsible officers of the Traffic Department to determine where we have slipped and to formulate a program for recovery of position. This, however, is only part of the story, as our pricing people are constantly examining not only the railroad market but the entire transportation field in relation to specific commodities in an effort to recover traffic from other modes. There is no question, and it has been well known for some time, that the PRR position in recent years overall has slipped in a number of major commodities. For your ready reference, there is attached an analysis of the more important of these areas. A generalized statistic confirming this is of no practical value. The figures used by you, for instance, ignore the impact to the PRR of the spectacular growth of the export coal market by the N&W and C&O, the impact of the sale of the Sandusky Branch, port strikes, major industrial developments, etc.

(The two most serious problems confronting the Traffic Department and its marketing division today are accurate cost formulae to help in formulating pricing policies and to guide determinations for the acquisition of new equipment. I think you will agree with me that we are a long way today from achieving those two goals, as we are still largely dependent on system averages applied to specific commodities and movements.) I understand that our computer people are now progressing in an effort to take more advantage of computer techniques, and I would urge that your department apply its valuable talents in expediting a breakthrough in those areas at the earliest practical date and to expeditious cost analyses when requested to do so.

H. W. L.

EXHIBIT 62

PHILADELPHIA, *November 14, 1969.*

MR. SAUNDERS: You requested we send you, as of possible interest to Mr. Gorman, the proposed Price/Cost Management Information System descriptive material as designed by George Wallace and the Market Research group. Attached hereto is a summary statement, a brief digest of the entire system, the full report, and a report on a computer run demonstrating the machine feasibilities of the system.

It is estimated there is a potential earnings improvement of at least $96,000,000 in the event this system is installed.

(There is no question about the shortcomings of our existing cost data. This is a severe handicap in making sound pricing and equipment investment decisions in the highly competitive transportation market. The M.I.S. has valuable added advantages in that the data produced through this system will provide operating personnel with accurate cost reactions to decisions in the field.)

I think the suggestion that we run a pilot study on the Delmarva Peninsula is highly desirable and would give all interested departments an opportunity to put a true valuation on this program.

We are prepared to make an illustrated presentation on this system on short notice in the event that either you or Mr. Gorman might be interested in seeing this.

H. W. LARGE.

EXHIBIT 63

THE PENNSYLVANIA RAILROAD CO.,
LABOR RELATIONS AND PERSONNEL DEPARTMENT,
Philadelphia, Pa., August 30, 1965.

Mr. F.L. KATTAU,
Assistant to President-Administration, New York Central Railroad,
230 Park Avenue, New York, N.Y.

DEAR FRED: I have just gotten through the conglomeration of material that confronted me on return from vacation. It was most thoughtful of you to prepare a memorandum summarizing the status of various merger planning projects. This has been invaluable as a guide and served to cut hours, if not days, in the time for me to get back in tune with what is going on.

Incidentally, Frank's write-up of your meeting on August 9 was well done. From that and various comments concerning it, I get the impression that it was an excellent meeting.

I am searching desperately for some concrete evidence of progress—completed projects, approved networks, etc.—but finding little. Nevertheless, everyone seems to be working very hard and I am sure there is as much progress being made as can be expected at this particular time.

I will try to have a summary ready for you on return.

Sincerely,

BASIL COLE.

EXHIBIT 64

APRIL 6, 1970 INTERIM REPORT—PRESIDENT'S TASK FORCE

The task force has spent the last five weeks evaluating the activities and functions of a region. We have looked into many areas to determine the strengths and weaknesses of the region.

There are certain visible signs that many areas need improvement. A few of them are:

1. High payroll costs. Annual earnings statements for T. & E. employes on the Cleveland and Toledo Divisions in 1969 showed:
   396 employes paid over $15,000
   233 employes paid over 16,000
   70 employes paid over 18,000
   8 employes paid over 20,000
2. High constructive allowance payments.
3. Quality of service—latest Ford Motor Co. and Allied Chemical Corp. service analyses and examples.
4. Lack of uniform procedures:
   A. Payroll and time claim processing.
   B. FCMR–MCR car reporting system.
   C. Management reports—Transportation and Finance.
5. Lack of defined duties and responsibilities in some supervisory positions and lack of uniformity in these positions between regions and divisions.

It is our opinion that these problems exist for several reasons.

1. Turnover in management at all levels.
   61% of Trainmasters in their present assignments less than one year.
   81% of Transportation Superintendents in their present assignment less than one year.
   44% of Division Superintendents in their present assignment less than one year.
   80% of Division Superintendents in their present assignment less than 15 months.
   All but one General Manager in his present assignment less than 15 months.
2. Lack of adherence to the operating plan.
   A. Grouping manuals and freight train schedules not up-to-date and not followed. Lack of discipline and follow-up.
3. General Managers have individually set policy in areas where system uniformity should prevail. A few examples are:
   A. Information systems.
      1. Financial & budget.
      2. Transportation reports.
   B. Timeslip processing and handling of time claims.
   C. Regional organization.
   D. Handling of people.
      1. Promotion.
      2. Replacement.
      3. Traininf.

It is felt that the tremendous turnover in supervision has had an adverse effect on operations and control. Different philosophies and concepts on how to operate a railroad existed in the two former companies. These simply don't disappear by changing the name of the company. Developing the one best way to operate the Penn Central requires that every supervisor must change to some extent. The difficulties in forming a solid cohesive team on each region and division are obvious and have been understated. With the turnover rate that has existed, the field level supervision has been constantly trying to adjust to changes in environment. They must learn new physical territory, new superiors, new operating rules and regulations, and new concepts and philosophies. All of this takes time.

It is recommended that the transferring of supervision be sharply reduced for a one to two year period in order to consolidate and stabilize. During this same period, it is further recommended that when transfers are absolutely necessary, a man should be transferred to a position where he has to make the fewest adjustments to change in environment. With the large number of changes in the past 15 months, there should be a sufficient number of people in each level of management now that are adjusting to a complete change and will be familiar with both sides of the merged company. Nearly every other problem we saw could be related to supervisory personnel that were not yet qualified to handle the duties and responsibilities delegated to them.

A concerted effort must be initiated across the entire system to adhere to the grouping manuals and scheduled freight train briefs. There have been changes in the grouping manuals, and some yards have not kept up with them. It is recommended that these manuals be revised as quickly as possible and that they continue to be re-issued at six month or yearly intervals so long as such revisions appear necessary. Each region on a daily basis should scrutinize train consists and take corrective action with the supervision involved to reduce cars moving in the wrong block, on the wrong train, or being handled in yards that could be overheaded.

It is recommended that the reports prepared by the Marketing Department on the quality of freight service between key points and for particular shippers be given wider distribution and more attention. The regions should analyze their service deficiencies, establish a program to improve the service and most important, follow through to see that the program is carried out.

The task force, while recognizing the lack of uniformity in many areas, has not yet covered enough of the railroad to say what should be the standard. Certain changes in the regional organization on the Western Region have been proposed and the division organizations on the Western Region will be investigated next to determine what each person is doing and what are the results of his efforts. The lack of defined responsibility in particular areas is spelled out in a separate report. It is our goal to define the duties and responsibilities more clearly in these hazy areas before leaving the Western Region. Separate recommendations will also be submitted to cover other areas where uniformity and standardization are required.

The task force has looked at various items of expense. Yard crew overtime is one example. In the Cleveland Terminal excessive overtime appears to be built into particular assignments. This item will be detailed in a separate report and recommendations to reduce it will be handled directly with the Superintendent of the Cleveland Division.

The task force will recommend specific training for field level supervision. The training that is most necessary is in the basic fundamentals and is on the job training. It is not the three day seminars or classes but rather a daily stress on the basics. Some of the items that should be covered are:

1. How to reduce overtime.
2. How to conduct investigations and trials.
3. How to reduce personal injuries and subsequent claims.
4. Labor regulations, local agreements and arbitraries which the supervisor must know.
5. Operating rules and safety rules.

We have talked to a great number of people on the Western Region. Nobody has really tried to hide anything from us. One of the most prevalent complaints we have heard is the inability to attract and hold good front-line supervisors. In this particular area, money is the key issue. The average Trainmaster earns between $10,000 and $13,000 per year on the Toledo and Cleveland Divisions while nearly 400 T. & E. employes under their jurisdiction earned over $15,000. It is felt that more use should be made of the merit increase plan for this level of management with emphasis on increasing the salaries of those that perform well rather than moving them to a new assignment at an increase in pay.

The physical condition of the yards in the Cleveland Terminal is of great concern to the local supervision. In Collinwood Yard alone, there were 78 reported derailments in February at cost of $37,712. There are strong indications this is not a complete record. Rockport, Kinsman St. and Motor Yard also are in poor physical condition. It is recommended that some programmed work be started, particularly in Collinwood, during 1970 even if other maintenance work has to be postponed.

It is our feeling that the greatest opportunity for improvement is in Transportation and it is in this area that we intend to concentrate.

There is a real need for defining the duties and responsibilities of the supervision in the Transportation Department. As an example, the following positions existed prior to merger on one railroad or the other but not on both:

Position	New York Central	Pennsylvania Railroad	Penn Central
Supervisor data control, division	No	Yes	Yes.
Supervisor data control region	No	Yes	Yes.
Supervisor yard procedures (principal yards)	Yes	No	Some areas.
Division supervisor operators rules (division operator)	No	Yes	Yes.
Chief dispatcher	Yes	No	Some areas.
Supervisor train operations, division (supervisor train movement)	No	Yes	Do.
Regional supervisor operations rules	No	Yes	Yes.
Terminal superintendent, division	Yes	No	Some areas.
General yard master (excepted position)	Yes	No	Do.
Terminal trainmaster	Yes	No	Do.
Superintendent station	No	Yes	Yes.
Supervisor stations	No	Yes	Some areas.
Supervisor industrial car control	Yes	No	Do.

It has been our observation that there is no uniformity from division to division and region to region in the duties and responsibilities assigned to these positions. The people in these positions are doing what they think the job calls for or what their superior thinks the job calls for. This is based primarily on past experience rather than any clearly defined list of duties and responsibilities that is uniform throughout the Penn Central.

This need for definition of duties and responsibilities is not limited to the Transportation Department but it is more critical in this area because of the inter-relationship between divisions, regions and system in every transportation function.

It is recommended that the duties and responsibilities of each supervisory position in the Transportation Department be clearly defined and implemented on a uniform basis on each division and region of the company. By doing this, the hazy areas of responsibility will be minimized and every supervisor in the Transportation Department will know and understand what his duties and responsiblities are and what those of his associates are no matter where he might be assigned. This is a necessary first step toward establishing trans portation guidelines that will be uniform throughout the company.

Exhibit 65

Penn Central Co.,
November 13, 1969.

Mr. Saunders: Enclosed is a memorandum which I prepared for discussion with you today.

It occurs to me that it may save some of your time if I place it in your hands in advance of my seeing you.

[Enclosure.]

David E. Smucker.

PENN CENTRAL MERGER WILL COST $125.0 MILLION IN FIRST TWO YEARS

Since February 1, 1968, Penn Central has expended or authorized expenditures of cash for merger-related projects or programs in excess of $95,000,000. This is over and above the cost of completing the Alfred E. Perlman Yard and diesel locomotive repair shop which had been advanced by the New York Central and was under construction. Including such costs indicates that the total sum involved (allowing for anticipated over-runs of actual costs above estimated costs) is not less than $125,000,000 either spent or authorized.

In general, these costs fall into four categories:

(A) $28.2 million for severance allowances to 3,338 employees through September 30, 1969 ($4.3 million charged to expenses and $23.9 million charged to the reserve).

(B) $6.6 million paid to train and engine service employees as guarantees for time not worked or miles not run relative to a base period. These figures comprehend payments made through August 31, 1969. Payments lag the liability by several months, however, but are charged to expenses when paid.

(C) $7.5 million in expense and moving allowances and real estate costs covering relocation of employees transferred to follow their work.

(D) $53.2 million to cover the cost of 25 merger-related physical expansions or relocations of fixed facilities authorized since merger and ranging downward from the $23.6 million estimated cost of the new classification yard at Columbus, Ohio. The proposed charges to capital accounts for these projects aggregates $50.8 million. Reduction in operating and other costs when all are fully in service is forecast at an aggregate annual rate of $30.9 million, 38% of the $81.0 million on which the merger was justified.

RESULTS ARE GROSSLY DISAPPOINTING

Post audit of actual versus forecast savings thirteen months after Alfred E. Perlman Yard went into regular service indicated that at Dewitt and Geddes St. in Syracuse and at Selkirk the net of identifiable savings over added costs at these three yard locations fell short of the forecast by $2.327,000, representing a short-fall in savings of 51.7%. Assumptions that forecast savings had actually been achieved at other points (such as the unrelated savings at Weehawken because that operation was consolidated at Greenville) lead to a statistically sound but misleading conclusion that the shortfall was only 43.9%.

PROSPECTIVE MERGER SAVINGS FROM SPENDING $125.0 MILLION LOOK LIKE $51.0 MILLION

Regardless of whether 43.9% or 51.7%, it seems prudent now (subject to further precise check) to expect annual cost reduction from investment of $53.2 million to fall somewhere between $15.0 and $17.3 million rather than $30.9 million.

If the employment cost of the 3,338 "present employees" who have been paid severance allowances averaged $10,000 annually, this action alone has reduced costs by $33.4 million. Adding this to $17.3 million derived above produces total prospective annual savings of $50.7 million compared to $81.0 million savings on which the merger was based, not to mention the somewhat higher figures which have been expected simply because of advancing unit costs.

THE MASTER OPERATING PLAN HAS NOT BEEN FOLLOWED

Being discontented with the plan for merged operation prepared under the direction of Messrs. Kenefick and Morris, and placed in the merger record by Witness Patchell, Mr. Perlman directed additional studies leading to preparation of a Master Operating Plan. When completed after many months of effort on the part of the best informed people on both roads, all copies were stamped "Preliminary" and withheld from distribution by specific direction of the man who had ordered it prepared.

By its very nature, it is an up-to-date and improved version of another operating plan which had supported the merger proposal by asserting a potential for saving $81-million annually at cost levels then in effect. As such, the Master Operating Plan is either a plan to save $81-million, inflated by increased costs of labor and material, or it is nothing. If the latter then there is cause to question what plan we have been following, as well as the much more important question "What plan will we follow in the future"?

Mr. Flannery has now authorized that copies of the Master Operating Plan be sent to the General Managers for their review and comment. (See his letter of October 14.) It is generally understood that little if any cash will be available during 1970 for Road Capital items. For whatever value it may have produced, the annual capital budget meeting has already been held. What effective use we can now make of the General Managers' comments in respect to the Master Operating Plan as it affects their territory is difficult to visualize.

We cannot now get back any of the money that has been spent but we can make sure that anything we spend from now on relates definitely to an identifiable objective which is in itself an understandable part of a whole plan to make one railroad out of two railroads, with operating costs in the area of $100-million lower than the cost of operating both.

PLAN FOR THE FUTURE

A. Expand the post audit function to determine the degree of savings currently being made from projects and programs which have been advanced. Drive to get more!

B. Identify the missing links between physical units which are limiting the savings. Where the benefit/cost relationship is most attractive and funds can be made available, push forward to improve the return from earlier investment.

C. Consolidate regions and divisions in the direction indicated by experience to date. It has been clear from the start that nine regions are far too many to be competently staffed and effectively managed. As a beginning, it seems perfectly feasible now to reduce this to six, realigned to most effectively deal with the problems which post-merger operation have pinpointed. It would be difficult to conceive of a less likely plan than the one which I understand to be under serious consideration—to eliminate the Lake Region by attaching the Cleveland Division to the Northeast Region and the Toledo Division to the Western Region.

D. Revive the system of budgeting and forecasting by responsibility centers, then comparing actually incurred costs with those which had been planned. There can be no more effective system than for *each* level of manager to control his own subordinates through the same number series with which he is called to account.

In view of the experience during the recent past, it will probably be wise to budget revenue-related units and dollars of expenses at relative levels which may produce system deficit figures rather than to insist that budgets reflect unattainable relationships, being forced, thereby, to deal with variances of meaningless and unmanageable size.

E. Recognize that revenue freight volume by Penn Central TrailVan service has been in a consistent decline while rail-highway services of our competitors have been increasing. The decline in patronage parallels investment of added millions of dollars in expansion of terminal facilities, additional vans and trailers, and more and more short high-speed train miles. We must begin a stern and non-paternal analysis of actual corporate profit rather than of paper profitability which comes only from the Treasury of the parent and, even when so subsidized, continues to decline in volume.

F. Reinstitute the maximum extent of local control, insisting on local assumption of responsibility to act as swiftly changing condition require. Except and be prepared for people undergoing training and experience to make mistakes. Deal more sternly with those who do nothing than with those who occasionally use poor judgment.

Consistent with this general policy, we should drastically curtail the local acitivities of system officers who have been wandering about aimlessly managing each day what they can see without regard to the effects elsewhere.

G. Reinforce and strengthen the activities of the planning organization and bring into this unit many related but independently functioning activities. We have wasted incalculable money and time because electronic data processing has been considered beyond the reach of those who have data to process.

Begin to plan toward a system of regular periodical review of methods, procedures, costs, benefits and relationships of every activity carried out by Penn Central Transportation. Nothing should escape review—nothing should be taken for granted—nothing should be considered permanent or unchangeable.

David E. Smucker.

Exhibit 66

Peat, Marwick, Mitchell & Co.,
Certified Public Accountants,
Philadelphia, Pa., December 22, 1969.

Mr. C. S. Hill,
Vice President-Controller, Penn Central Co.,
Six Penn Center, Philadelphia, Pa.

Dear Mr. Hill: We were requested to perform an outside investigation of the freight billing system used by Penn Central Company. Using both Penn Central and Peat, Marwick, Mitchell & Co. personnel, three review teams were organized to conduct such a study. The accompanying report relates our findings, conclusions and recommendations resulting from this review.

FINDINGS

We did not find a major occurrence resulting in the failure to collect freight revenue. However, we did find serious weaknesses which prevent billings being rendered to patrons on a prompt basis. Actually, we consider these delays to be excessive. The current system is almost totally dependent upon quality performance by agreement personnel. Management control over the quality and promptness of rendering bills to patrons is too late in the system and otherwise inadequate. The only current method of detecting whether agencies are promptly preparing revenue waybills for patron billing is by physical inspection and research.

The errors and inaccuracies in the system as noted during the study occur in two critical areas. The first is revision. Inaccurate rating generates an excessive volume of disputed bills. The result is a lengthening of the collection cycle with additional effort expended toward resolving the disputes. The second area is in accounts receivable-cash application. We detected a recent alarming build-up of unresolved and overage items which were not being resolved at certain locations—notably Indianapolis and Detroit. Credit and collection performance deteriorates as these two situations worsen.

CONCLUSIONS AND RECOMMENDATIONS

The major concern we have is that the current control systems are too late and do not attempt to relate car movement to freight billing. The post audit computer system has not functioned since the merger. On the other hand, we sampled and examined physical car movements and related records to determine if billing was rendered. While our sample was small, because of timing requirements, we found the car movement consist records to have a reliability of approximately 95% which improved to better than 98% when trains in Eastern New York were excluded. Based upon our findings, we recommend a mechanical control system be designed, developed and installed so as to reconcile billing and car movement records. Such a system will also provide management reports for follow-up purposes. We also recommend that procedures be established to better control the transmittal of paperwork.

Secondly, we found sufficient evidence of confusion and inadequately prepared personnel which indicate that the training programs of the six Supervisor of Revenue Accounting (SRA) offices are inadequate. We recommend that a specific training program be developed for the revision area which would embrace all aspects of tariff interrogation. Also, we recommend that abbreviated procedures manual be prepared for the accounts receivable area on a position-by-position basis. These manuals should contain specific illustrations of the various transactions.

As our study progressed, we became more convinced that the recent organizational change which placed the agent under the jurisdiction of the trainmaster threatens a basic financial control technique. That is the check and balance feature of the former Agent/Trainmaster relationship wherein one party is primarily responsible for providing service and the other for properly recording the transaction for financial control purposes. We recommend that this organizational change be re-evaluated.

The area of miscellaneous charges, particularly intra-plant switching and placement for patron convenience is totally dependent upon personnel providing documentation that the services have been rendered. Based principally on interviews (crew riding was not included in the study) we were appraised of a number of circumstances wherein the Penn Central was not compensated for revenue moves. To prove or disprove such an occurrence requires a separate and distinct type of audit. To insure collection, we can see the possibility of developing a system of documentation tied into a work performance system. That is, work performed is measured and the performance appraised. Since the moves made are recorded under this concept, the data is then available as billing support.

Finally, we observed two agency locations with probably the worst working conditions we have ever seen—Kalamazoo and Niagara Falls. It is inconceivable that personnel working under these conditions can perform quality work commensurate with the rest of the system. We recommend, notwithstanding capital improvement budget limitations, that steps be taken immediately to relocate these two agencies.

We appreciate the opportunity afforded us of participating in this study. We would particularly like to commend the excellent assistance rendered us by the three industrial engineers assigned by the Penn Central to the study teams.

The accompanying report is a summary of the individual team reports prepared by region which are in turn a summary of the detailed working papers. This documentation and specific examples of findings will be made available to you or your staff as you require.

Yours truly,

PEAT, MARWICK, MITCHELL & CO.

[Attachment.]

I—INTRODUCTION

During the period of time elapsed since the former Pennsylvania and New York Central Railroads were merged, major difficulties have been encountered in establishing workable procedures which would permit the uninterrupted continuation of the merged Penn Central operations. Paperwork processing, particularly in the areas of billing and revenue accounting has presented serious problems. Comments and questions have been raised from time to time as to whether major failures in the revenue control system could have occurred during the transition period. Such questions have been raised by patrons as well as by Penn Central management.

Penn Central management decided that it was desirable to retain an impartial third party to make a procedural audit of the freight billing system. Peat, Marwick, Mitchell & Co. was selected to make such a review. In conducting this evaluation we organized three teams to perform a procedural audit of the Supervisor, Revenue Accounting (SRA) locations, as well as selected agencies and yards and terminals. At the same time we observed paperwork handling techniques and tested car movement records.

PURPOSE AND SCOPE OF THE REVIEW

The review was performed to determine if a significant breakdown was occurring in rendering freight revenue bills to patrons for services rendered. Specifially, the teams were charged with determining if a large number of revenue movements were unrecorded or the paperwork overlooked, misplaced, etc. and therefore not being billed to patrons and collected.

The next point was that if this condition existed, was it caused by a basic weakness of the overall revenue procedure or did it happen because practices were not in compliance with standard procedures. In conducting the review, the teams analyzed the effectiveness of both procedures and practices in the major functional areas of SRA, Agencies and Yards and Terminals. These areas have the principal control over initiation and control of the freight revenue procedure.

Another objective was to establish whether control elements of the revenue procedures were adequate and timely. Also to be determined was if these controls were being applied across all aspects of the revenue responsibility. Consideration was to be given towards the effectiveness of procedures, practices and controls, so as to assure the reconciliation of actual services rendered to freight revenue billed and collected.

Finally, as the study progressed, it became obvious that we should devote attention to the area of miscellaneous charges particularly in intraplant switch moves. Rather than attempt to develop an audit program, we reviewed procedures, observed paperwork flow and implied or real controls.

ORGANIZATION OF THE STUDY

Our approach toward establishing adequate review coverage was to organize three teams jointly staffed with personnel from Peat, Marwick, Mitchell & Co. and Selected Penn Central employees. Each team consisted of two Peat, Marwick, Mitchell & Co. personnel and one industrial engineer from Penn Central. The teams visited and performed observations and analyses in all regions with the exception of the New Haven region. It should be noted that coverage in the Lake Region was very limited. The following is a listing of the number of facilities visited by the teams and where some degree of review was performed:

8 Regions
6 SRA's
51 Agencies
81 Yards or Terminals

The Penn Central engineers assigned to the teams as well as other Philadelphia personnel made most of the advance arrangements for the visits to insure that the teams dealt with responsible parties and to minimize delays. This advance planning greatly accelerated our progress.

Before the teams left System Headquarters, a series of briefing sessions were conducted by representatives of Penn Central accounting and operations. After the teams had visited the first three SRA's and four regions, a debriefing session was conducted in Philadelphia. The review approach was then revised to develop more specific statistics and analyses from the remaining SRA's and regions. After the second series of visits and reviews, another debriefing session was conducted. The teams then committed to writing their significant findings and conclusions for each region and SRA visited. This letter summarizes the team reports. Finally, three oral presentations were made to Penn Central management—two after the first series of visits and one after the second set of visits.

II—FINDINGS

In the brief time we spent in the field we did not find major occurrences of revenue loss to Penn Central. However, the purpose of our study was not to uncover specific occurrences of lost revenue but rather to examine from a systems viewpoint the systems and controls in effect. We have uncovered some major deficiencies. These findings will be stated in the following major functional areas.

SRA

In all SRA's visited and reviewed, the accounting procedures which are formally designated as AD 206 and AD 260A were being followed. This was confirmed by the practices observed and review of the records maintained.

(a) Paperwork Control

We found that effective batch controls over the input source documents were not part of the system throughout the functional areas of SRA. Logs are not maintained for input, with volumes of waybills or specific waybill data by related agency. The criticism of random processing without proper control of waybills is applicable to all departments of the SRA as well as data processing at the SRA locations, which is not subject to the authority of the SRA's. This lack of paperwork control makes resolution of errors, tracing and waybill identification difficult. As a result, serious delays develop. In addition, there is a lack of

positive control preventing the loss of waybills while being processed throughout the SRA. Finally, the quality of performance is not closely controlled to minimize human errors.

The system is not designed to eliminate the many possibilities for misinterpretation. If an error is generated in the system, it will normally flow through the entire cycle of EDP recording and patron billing. This condition is not brought to the attention of the SRA until it is made known by the customer or by the agency in the event the transaction is for a cash customer. In summary, the SRA lacks a positive control system that insures revenue waybills and patron billing are submitted for all revenue moves reported.

(*b*) *Personnel/Training—Revision*

A critical personnel situation exists at most of the SRA's visited. This is especially applicable to the rate revision area which is the one that demands the greatest skill, yet the incentives do not exist to attract or maintain individuals with the needed skills.

The lack of experience currently existing is exemplified by the condition in Detroit. Of the 18 personnel in revision, 6 have 14 or more years of service; 9 have less than 1½ years; and the remainder falling between the two extremes.

The revision section of the Eastern Region SRA (Philadelphia) will lose an estimated 51% of the total years of railroad service between October, 1969 and June, 1970 due to retirements. The breakdown of personnel by service is 6 with 12 years or more service, 6 with 1 to 12 years service and 6 with service measured in weeks and months.

We did not observe any formal training during our visits to the SRA's. We have been advised that one individual tours the SRA's for this purpose. Obviously, a much more meaningful program is necessary to replace and train personnel to cover loss of experience. Job training techniques that were observed must be termed informal. The practices we observed could best be defined as "on the job" training, supplemented only by brief clerical instruction. SRA management appears to have little time to practice follow-up reviews on training progress or more important the subsequent capabilities of the personnel holding positions. Lead clerks and supervisors fill the voids in order to process the work.

(*c*) *Accounts Receivable*

Another significant area that indicates a need for control is the unsettled accounts receivables. Specific examples of uncontrollable items were revealed throughout this area. One practice discovered at an SRA was the use of a fictitious patron account titled the "Paul P. Account". This is a suspense account for disputed transactions. Such unsettled items are held there until resolved by the lead clerk in the correction section in Indianapolis. To control and eventually eliminate the use of this account, a continuous account analysis is required. In reviewing this account at one agency, we found that items were not promptly resolved. In addition, we were not able to determine that standard procedures permit this practice since the open item loses its identity in the EDP system when it becomes a "Paul P." item.

(*d*) *Correspondence*

The volumes of disputed correspondence that were evaluated during our visits to SRA's indicated a significant problem related to the effective control of revenue. This correspondence was primarily related to patron complaints regarding rating errors and duplicate billing. In addition, examples of triplicate billing resulted in stronger than normal commentary from reputable patrons.

(*e*) *Inexact Cash Remittances*

Another problem area detected was the recording and accounting for cash remittances by the Bank Remittance Customers. The bank receives and processes these payments by type of transaction. Group I is composed of checks for payment in full accompanied by remittance cards. Group II includes checks and statements from which the bank prepares a remittance card. Group III consists of checks supported by limited detail but not sufficient to be included in Group I or II. Group IV includes checks received with no supporting detail to identify payments.

Groups I and II should present no problem for reconciliation. The volume of Groups III and IV remittances currently are ranging from 45% of total remittance as reviewed at the Indianapolis SRA to 68% at the Detroit SRA. These volumes are based on dollars and not on open items. We have been advised that Groups III and IV represent about 25% of the transaction count of accounts receivables (unsettled) at this current time. The open items not resolved are transferred to the overage and advances (O&A) account.

(*f*) *Cash Application*

Inherent in the system is a time limit that necessitates the accounts receivable clerk making journal entries to post the actual amount of money received from the bank deposits. If the payment is not identified by the cutoff time, the unidentified portion becomes unapplied credits. The clerk will receive from data processing a cumulative total of all payments received which must balance to the statement submitted by the bank. An attempt will be made to further identify items that were recorded as unapplied credits. If the unapplied credits are not identified the day they are recorded, these transactions may remain in this account for several months, as evidenced at the Indianapolis SRA where unapplied items were generated back in May, 1969. Based on volumes currently outstanding it appears that considerable unapplied credits could remain unresolved indefinitely, with the contra effect somewhere in accounts receivable (unsettled). Since these unapplied credits do not erase the receivable from the tape, the patron will receive a delinquency notice ten days later for a bill that has already been paid. This condition influences the major problem of excessive

correspondence on a daily basis. Credit and collection practices become of academic interest when the unapplied credit and O&A account balances increase.

The high volume of rating errors which came to our attention have greatly contributed to the conditions described above.

(*g*) *Forced Waybills*

While attempting to resolve open items at one agency we uncovered several occurrences of forced revenue waybills. These were detected at the Charleston, W.Va. agency, with processing through the Indianapolis SRA. Four waybills amounting to approximately $2,000, which were readily identifiable as prepaid, were processed as collect waybills. The patron is fully cognizant that these bills are in error and, therefore, will not remit. Currently, these bills remain in the unsettled account status. To aggravate the case cited, the cars involved were interline movements involving percenting and settlement with a foreign road. This settlement was made, therefore the loss of revenue resulting from this act was magnified. A question that remains with us is what volume of similar incidences exist, undetected, throughout the system.

(*h*) *Current Revenue Waybill Follow-up*

We were made aware of serious deficiencies in the AD 1634 and AD 1635 control program. The volumes of AD 3604's, the inquiry request submitted at month's end by the agent to the SRA for resolution of waybills unreported by the SRA exceeds the SRA's ability to respond. During our review, little was being accomplished by the SRA's in answering these AD 3604's. The situation is rapidly deteriorating. As an example, the East St. Louis agency is experiencing the following accelerating volume of 3604's:

July, 1969—126 items
August, 1969—146 items
September, 1969—579 items

A similar progression but with higher numbers exists at Buffalo.

AGENCIES

The following findings were observed in the reviews of selected agencies. As stated earlier, in our report, it is our opinion that these findings could have unfavorable effects upon revenue control and efficient cash flow.

(*a*) *Agency Control Forms*

In our reviews of agencies, adherence to the AD 1634 and AD 1635 control program was unfavorable. The attitude of a great percentage of the agents toward this program may be defined as non-acceptable with certain agency personnel making little effort toward complete adherence. In a specific agency (Cincinnati), a memorandum was issued by the agent ordering his people not to adhere to any segment of the 1634's and 1635's because of lack of personnel. Copies of this memo were sent to the SRA instructing the Supervisor of Revenue Accounting to discontinue submitting reported waybill statements to his agency.

In many agencies delays in preparing 1634's and 1635's destroy the value of this intermediate control program. The reasons most often given for this breakdown were the budget cut or organizational change wherein the agent reports to the trainmaster.

Another condition that existed at the agencies was the lack of a transmittal control between agency and SRA.

We found poor morale existing throughout most of the agencies. This personnel atmosphere was primarily the result of the recent budget cuts. The across the board force reduction, as observed, was being often applied to personnel performing functions directly related to revenue document processing or, as mentioned earlier in this report, revenue control functions at agency level.

(*b*) *Memo Waybills*

Delays in revenue processing and possible loss of revenue could result from excessive use of memo waybills. The continuation of the practice of using memo waybills to move cars and trains has put a severe strain toward timely processing of revenue waybills. As agency forces are cut, this practice will increase with the result of pyramiding the work to resolve the memos. The threat of loss of revenue becomes more critical when volume repetitive movements are involved as was the case pointed out at our progress meetings in connection with Midwest Steel. Large volume memo billing also presents a difficult control problem at East St. Louis.

Deficiencies in waybill numbering were observed at a few agencies (Toledo, Buffalo and Detroit). An example of this was observed at Todelo and Buffalo where waybill numbers were not always used. Detroit was using its own waybill numbering procedure which presented a problem with regard to standardization and uniformity.

(*c*) *July 1 Study*

Our follow-up of a few unresolved car placements that appeared as a result of the "*July 1, 1969 study*" proved successful. The purpose of the "July 1" study was to identify all car placements of that date as shown in the car movement records (waybill records) and match the data to related waybill data processed by the SRA. The objective of this study was to determine if revenue waybills were being processed by matching mechanically and resolving exception items manually. With the information available to the review teams, the agents at Dayton, Ohio and West Carrollton, Ohio, were in position to resolve two cars appearing as "no bills". Not only did the agent process the two outstanding cars but a third car which was outstanding as a no bill on the AD 1634 for that date, with the

same destination, consignee, origin, routing and freight, was way-billed based on the information provided by the Manager, Revenue Accounting. This experience demonstrates the possibilities of improved control that could result from the proper use of mechanical car movement data.

YARDS AND TERMINALS

The following findings were observed in the reviews of selected yards and terminals. As stated earlier in our report, it is our opinion that these findings demonstrate an unfavorable impact upon revenue control and efficient cash flow.

(*a*) *Illegal Form*

Observations at yards and terminals detected the use of an illegal form at one location. This was the use of the T–1572 form at Detroit. This is a single copy record originally designed to document miscellaneous charges. Use of this form presents a potentially serious revenue problem. That is, if this single copy record is lost then there is no defined follow-up system to force revenue recovery. We found cars that moved from Niagara Falls to Kalamazoo on this document. These cars were forwarded through Detroit.

In addition, during our visits, we observed miscellaneous and sundry forms, papers, etc., used as legal documentation to move cars. These non-standard forms are substitutes for waybill forms.

(*b*) *Prevailing Attitude*

Throughout our visits and contacts, one consistent finding prevailed and this was the attitude that "moving cars has priority". The operating and transportation personnel we talked to typically showed little concern for revenue control and processing of source documents related to freight revenue.

(*c*) *Miscellaneous Charges*

The status of reporting, processing and control of miscellaneous services could be classified as questionable. The system, regarding miscellaneous charge revenues collected from patrons, is only as good as the reporting performance by operating personnel. At the Homestead, Pa. agency there were occurrences where the original source document, AD 1582, the conductor's switch list, was not transmitted to the agency. In these particular instances, revenue was lost by Penn Central. The current system does not have a control technique to verify actual miscellaneous services performed to billings rendered.

(*d*) *Physical Check of Trains*

Considerable time and effort was spent to check the accuracy of physical car movement records versus the related data posted to official source documents, such as train consist, AD 1580, AD 1582, AD 1634 and AD 1635. The results of these observations follow:

1. 1,838 cars were virtually checked and verified against the consist. Of the total there were 69 "no bills", 6 bad car numbers and 17 overbills.

2. 322 cars were checked and verified between the AD 1580 and 1582 and the AD 1634 and 1635 with 12 errors resulting.

The review for item 1 above indicates a 5% error factor for both types of source documentation. This random physical checking was performed in yards across a representative section of the system. However, if the errors found in the New York Region (59 no bills and 16 overbills out of 844 cars) are eliminated, the error percentage drops to a very respectable 1.7%.

In addition, because of our commentary at an oral presentation following our first series of visits, the Eastern Region provided an industrial engineer to test cars moving out of Sparrows Point, Maryland destined for Bethlehem Steel in Burns Harbor (Portage) Indiana. We were advised that of this test of approximately 1,000 cars, one car appeared in error. This car moved on the consist records as an empty whereas it was apparently under load. Were these movements added to item 1 above, the error percentage drops to 3.3%—furthering the validity of utilizing operations computer records in a revenue control system.

ORGANIZATION

It is our opinion that the recent reorganizational change placing the responsibility for the agency under the control of the trainmaster is not in the best interest of Penn Central. This action tended to weaken a basic financial control check and balance that had been in existence. Specifically, based upon our field visits, we believe a basic conflict of objectives exists between the agency and transportation management. The main objective of the trainmaster is to move trains and cars, while the agent's primary concern is seeing to it that car movement paperwork is properly generated and car movements are properly waybilled.

A strain will be placed upon the agent's ability to carry out his prime responsibility of safeguarding freight revenue if he reports organizationally to an individual who does not have similar motivation.

We were made aware of several situations in which the agent's subordinate relationship to the trainmaster required the agent to be utilized for non-agency functions. As an example, at Massey Yard in Watertown, N.Y., the agent was instructed by the trainmaster to ride yard engines to conduct time studies of the engine crews. At Niagara Falls, N.Y., the agent was resolving items on the morning "T-reports" for the trainmaster and thereby was prevented from resolving the agency problems (later in this report we recommend an audit of this agency). In both situations the agents had pressing agency problems demanding their undivided attention.

AUDIT

While in the Chicago SRA, our study team was provided a list of cars by the Supervisor of Revenue Accounting. This list, prepared by Midwest Steel Company, totaled 841 cars which Midwest claimed had never been billed. It covered a period from August, 1968 to June, 1969. As a result of this finding an audit was recommended in a progress review meeting. Action was initiated at that time and an audit was begun in late October, 1969. Following is the status in this matter as of our last updating in early December, 1969.

Audit findings	Number of waybills	Number of cars	Amount of freight
Billed prior to the patron's list	34	507	$247,700
Billed after patron's inquiry, but before agent was notified	5	101	34,000
Billed based upon the audit teams findings	12	233	79,900

We were also critical of the billing situation with regard to movements from Buffalo, New York and Sparrows Point, Maryland to Bethlehem Steel at Burns Harbor (Portage), Indiana.

III—CONCLUSIONS

We found isolated instances wherein billings had not been rendered on revenue movements for several months. While it may be premature to consider this "found" money, it is indicative of what we believe the revenue accounting situation to be on the Penn Central. As an oversimplification, the system relies almost totally on personnel until the bill is processed by the computer at the SRA. That is, the Company relies on personnel to accurately identify that a waybill is missing, trace the bill and follow-up so as to eventually clear such an unresolved item. Since the merger, a post audit of movements to billings still remains an objective not a reality.

The following paragraphs summarize our conclusions resulting from our study of the freight revenue billing system.

APPLICATION OF CONTROL TECHNIQUES

There are several controls existing in the current system. The first control of billing at the agency level is the use of the AD 1614—Daily Memorandum of Waybills Forwarded, A.D. 1634—Record of Inbound Movements and the AD 1635—Record of Outbound Movements. One only control over the use of these forms is fostered by audit visits or correspondence from Company personnel. From our visits, we found the use of these control forms was generally perfunctory except in Michigan. The 1634 and 1635 forms are to be reviewed by the agents and an AD 3604—Notice of Discrepancy forwarded to the SRA for resolution when the agency believes it has discharged its responsibility and sent in the revenue waybills. The follow-up by the SRA on the AD 3604's is sketchy at best from what we have been able to determine.

It is our considered opinion that the controls placed upon the billing operations are applied too late in the system. The control over follow-up on missing revenue waybills or memos is a loosely structured arrangement based upon the personal commitment of the agents, field audits or response to patron complaints. We believe a control technique should be instituted as close as possible to the timing when a revenue movement is made. Because a post audit has not been a reality since the merger, we believe a more current audit trail must be created and administered.

TIME DELAY

While we have only limited sample data regarding the interim between car movement and preparation of revenue waybills, all signals point to a significant delay being encountered. We observed a heavy proportion of the traffic moving on memo waybills. This observation was confirmed by System Headquarters which indicated that about 60% of the traffic moves on memo waybills.

We believe the Penn Central is delayed in rendering of bills and cash collections because of the memo waybill situation. We observed a generally poor attitude in the field as regards revenue responsibility. A good part of this can be attributed to the recent budget cuts. If only as a self defense mechanism, we believe a control system is required to identify revenue movements and for use as a reminder, suspense or prodding technique to force more timely adherence to producing revenue waybills.

BILLING INACCURACIES

In our visits to the SRA's we attempted to analyze the accuracy of the billing system. The SRA's maintain quantity control reports for productivity information but not qualitative reports. There are two critical areas currently at the SRA's. One is the revision area, wherein errors create a more complicated workload, and non-payment of bills by patrons. Our review of correspondence, confirmed by our own sample, points to a growing awareness on the part of patrons of the poor quality of the Penn Central rating function. Increased emphasis on rate clerk training and quality of output is essential.

Another key area demanding attention at the SRA's is Accounts Receivable. Proper application of cash and resolution of errors is weak in several SRA's. As the Unapplied

Cash account increases, the ability of the Company to enforce proper credit and collection procedures decreases. The Overages and Advances (O&A) accounts must receive management attention. Training personnel to properly clear and resolve patron accounts, task forces to reduce these accounts and employment of good rating techniques are necessary ingredients for placing the Company in a position to confidently collect and follow-up on outstanding patron balances.

MISCELLANEOUS CHARGES

In our observation of the initial recording and subsequent billing of miscellaneous charges we once again conclude that control is strictly dependent upon personnel. While we were able to detect a few instances wherein billing for these services is not performed due to lack of notification (lost or unprepared documentation) we were particularly concerned over the implied weakness of the system-reliance on personnel and legibility of writing. We have concluded that the only type of system which might establish a more positive control over billing these services is to have the initial recording of the service performed as part of a regular performance evaluation system. As an example, were it necessary for crews to justify time spent in zone by recording production statistics which would be evaluated to performance measurements, then it seems that the record-keeping should improve in order to obtain credit. This recording of production data, after use in performance evaluation, could then be forwarded to agencies for billing.

Another alternative would be to develop an incentive system to reward personnel for advising the Company of revenue charges. A monetary reward is normal to an incentive system.

Whatever solution is determined by the Company, some type of system for controlling miscellaneous charges appears necessary. Currently the reliance is placed upon personnel with administration being an uncertain or irregular activity.

PERSONNEL

As an overview of the personnel situation of the SRA and agency level, we found the Company with alarming gaps in certain age groups of employees. This is the area between five (5) years and fifteen (15) years of railroad service. Some of the reasons for this void may be the Company's inability to compete with industry from a salary or working condition standpoint. However, we are most concerned with the effort on one function which we believe is critical to the Company-Revision. These positions are the key to the disposition of disputed bills amounting to approximately 11% of the unsettled accounts receivable for the Company. There should be no misunderstanding—the revision positions are the most demanding in most SRA's. This is due to the intense concentration and memory retention requirements. We recommend that steps be taken to reduce the employee turnover experienced on this position. This might be done through making the position sufficiently attractive to attract more senior agreement personnel by adjusting the rate. Another alternative could be to establish a restricted roster for these positions and exercise the disqualification rules rigorously. We are certain there are many other alternatives available. The important thing is to achieve a larger retention period for these valuable employees and increase their effectiveness.

WORKING CONDITIONS

After visiting the Kalamazoo, Michigan and Niagara Falls, New York agencies, we believe that while custodial services and a certain amount of redecorating would be beneficial in many other locations, the working conditions in these two locations were deplorable. Realizing the difficulties of justifying capital expendtures, we believe strongly that the working environment in the two locations mentioned must be improved.

IV—RECOMMENDATIONS

We have already discussed in this report many of our recommendations. However, for convenience and emphasis we will briefly restate in this section the recommendation areas already covered as well as additional ones that we consider important.

MECHANIZED CONTROL SYSTEM

The existing revenue billing system is overly reliant upon people for its satisfactory operation. Considering the railroad environment, this being continuous bumping produced by the bidding procedures, the low education and lack of exposure to formal training and the generally poor morale of field personnel, it is our belief that a system primarily dependent upon individual performance is dangerous.

We recommend that a mechanized revenue control system be designed and installed as rapidly as possible. Such a system is feasible and can be constructed by modifying reports and computer routines already available. A particular problem, as yet unresolved, is the handling of more than one car moving and a single "blanket" waybill. We do not believe the control system should be deferred for this reason since we are confident a satisfactory arrangement can be worked out. Our suggested approach to the development of a mechanized control system for freight revenues is described in our letter to you dated December 15, 1969. We estimate that the system could be installed and functioning in a period of time not to exceed 50 weeks.

TRAINING PROGRAMS

From our observations we are forced to conclude that the current training programs for personnel involved with the freight revenue billing cycle are inadequate.

We recommend that Penn Central institute a comprehensive training program focusing primarily upon the areas of greatest need—revision and accounts receivable. With regard to revision, as was mentioned earlier, the revision of freight bills is probably the most difficult function in the SRA. A competent revision clerk must be thoroughly familiar with the entire railroad tariff structure applicable to the Penn Central. He is contending with specialists in the patron organizations when he becomes involved with a rate dispute.

Considering the growing shortage of experience in this specialized area, we see no alternative to embarking on a comprehensive training program, including prepared text material, classroom lecture instruction and procedures manuals with detailed, illustrative examples.

There is a similar need for training in other areas also. The instruction available in accounts receivable are vague and sketchy. Detailed procedures for corrections, handling of exceptions and standardized treatment and response to patron correspondence are all urgently required now.

ORGANIZATION

The decision to place the agents under the responsibility of trainmasters weakens one of the subtle but nevertheless essential document control techniques operative in the field with regard to freight revenues. The trainmaster's primary concern is for the movement of cars and trains, and rightfully so. The agent, on the other hand, is deeply involved with seeing that the proper documentation is established for the moves taking place. They have conflicting objectives and their interests follow dissimilar lines. It is a violation of good procedure to have the individual responsible for the financial audit of an operation to be reporting to the individual responsible for the operational part of the system.

We strongly recommend that this organization re-alignment be re-evaluated.

SRA-EDP CONTROLS

A paperwork control system between the agency and SRA was recommended elsewhere in this report. Within the SRA, we also recommend that batch controls be established within the SRA manual and EDP processing areas. Documents manually processed by the SRA should be controlled prior to forwarding to the data processing area. The output from data processing should then be reconciled to the input. At a minimum, the batch control should include a count of documents released for keypunching.

We also believe that key verification be required at the data processing facilities when processing revenue accounting data. While key verification is supposed to be the practice, we noted that this practice is by-passed on occasion.

AGENCY CONSOLIDATIONS

There are a large number of agents, in two divisions, handling traffic routed to New York, New York. We were informed that there are approximately 70 agents (including relief agents) and 235 station identifications for this area. Problems noted while in the New York region were that documents and cars are being mis-routed because of confusion as to which agent is responsible.

We recommend a review be made by the Stations Department to determine if there is a possibility for agency consolidations to assist in reducing the mis-routing of documents (waybills, traces, etc.). In any case, a better means should be developed for exchanging information and paperwork.

IMPROVED WORKING CONDITIONS

As a result of our field visits, we believe that the working conditions at Kalamazoo, Michigan and Niagara Falls, New York agencies must be improved. We cannot believe that the work performed in those agencies is consistent with the rest of the System after observing the working environment.

RECOMMENDED AUDITS AND TASK FORCE ASSIGNMENTS

One special audit began while our study was in process—Midwest Steel of Burns Harbor (Portage) Indiana. Also, at the New York SRA a task force from System headquarters was assisting in the areas of training, working assignments and actual processing. We would like to recommend additional assignments for both groups.

(a) SRA's

We recommend that the Indianapolis and New York SRA's O & A (Overages and Advances) accounts be audited. Specific attention should be placed at Indianapolis on the fictitious "Paul P." account. Also, we suggest these two SRA's plus Detroit be reviewed regarding the form AD 3604 submitted by the agency for items listed as forwarded by the agency but not reported by the SRA. This form is a basic control in the current system. When it is not resolved by the SRA, the agency not only must relist items but there is a tendency for it to lose confidence in the SRA furthering a deterioration of the attitude towards revenue in the field.

(b) Agencies

We recommend an audit be conducted at the Niagara Falls Agency. In reviewing physical movement records, we found five (5) unreported items out of forty-six (46) examined, or over 10%.

Currently, an audit is being conducted at Burns Harbor regarding movements out of Great Lakes in Detroit to Midwest Steel. We recommend that this audit be expanded to include Bethlehem Steel inbound movements out of Buffalo, New York and Sparrows Point, Maryland

QUALITY CONTROL—SRA

We recommend that a system be implemented at the SRA's to determine the quality of work being done in the revision area. There are at least two alternatives open. One would be to evaluate the disputed items only. Maintaining logs on the revision clerk involved as to how the item was settled—favorable or not—would indicate which clerks require training or disciplinary action. One of our objections to such an approach is that the statistical sample is limited and therefore skewed to only disputed items. Another objection is that disciplinary action with agreement personnel would be difficult.

Another alternative, which is more comprehensive, is to conduct the analysis on a more reliable technique—random sampling. The computer records for selected days of billing could be analyszed and generate those items or bills to be re-worked by a senior or lead clerk. The logs could also be maintained on individual performance. An additional advantage of the latter approach is the ability to predict what the current exposure is for future disputed items, based upon past experience. Since the tests would be made by SRA, additional assistance could be applied, where indicated, by introducing short-term training programs in the revision area or by reallocating personnel to work on the O & A and unapplied credits accounts.

MISCELLANEOUS CHARGES

Due to our limited data in this area, we cannot make a positive recommendation. We were advised of and shown isolated instances wherein intraplant switching and physical placements for patron convenience were not properly billed. As you know, special services rendered are difficult to control and bill particularly where the supervision is not in visual contact because the individual(s) rendering the service finds it is to his advantage not to report the service.

We are offering two possible methods for consideration. The first is to introduce a work measurement program which encourages the individual(s) to report all services rendered in order to obtain credit for them. This type of system will not eliminate "unreported service" but should reduce it since providing this service normally requires a certain amount of time.

The second is an incentive program which rewards the individual(s). To obtain the incentive pay, there must be valid documentation and the billing should be undisputed. The disadvantage here is in the inability to collect a smaller than normal bill and the tendency to write off bills for which collection expense exceeds the face amount of the bill.

We tend to favor the first alternative since it also provides a desirable visible performance rating. This is an opportunity to instruct operations personnel in control techniques which then lead to planning techniques.

PROTECTING AGREEMENT POSITIONS

We recommend consideration be given to protecting the revision positions at the SRA.

EXHIBIT 67

U.S. DEPARTMENT OF JUSTICE,
OFFICE OF THE DEPUTY ATTORNEY GENERAL,
Washington, D.C., September 4, 1964.

MR. STUART SAUNDERS,
Chairman of the Board,
Pennsylvania Railroads,
New York 1, New York.

DEAR MR. SAUNDERS: I am enclosing a copy of a memorandum signed by Mr. Kennedy while Attorney General which, I believe, accurately reflects the discussion and comments which he made at his last meeting with you. He has taken the action indicated in the memorandum.

I might add that I am in agreement with his conclusions.

If you have any further questions, please do not hesitate to telephone me.

Sincerely yours,

NICHOLAS DEB. KATZENBACH,
Acting Attorney General.

To: Attorney General.
Subject: Penn-Central Merger.

Messrs. Stuart Saunders and Alfred Perlman, the presidents of Pennsylvania Railroad and New York Central Railroad, respectively, and Mr. George Leighty, Chairman of the Railway Labor Executives Association, came to my office on August 21, 1964, to discuss

the Government's position on the proposed Penn-Central merger. Mr. Katzenbach, Deputy Attorney General, and Mr. Orrick, Assistant Attorney General in charge of the Antitrust Division were also present. Mr. Saunders urged that we publicly reverse the Government's opposition to the Penn-Central merger, most recently stated in the brief filed with the ICC on June 1, 1964. He and Mr. Perlman explained in detail why they believe the merger to be necessary to the survival of their railroads. They reasserted their previously expressed willingness to cooperate with the Department or the ICC in assuring that transportation services will continue to be rendered by the New Haven Railroad and that such services will not be impaired by the Penn-Central merger.

Mr. Saunders explained that under the ICC order in the N&W-Nickel Plate merger case the Pennsylvania is confronted with the immediate necessity of deciding whether to dispose of its substantial stock interest in N&W, such divestiture being a condition of ICC approval of that merger. Mr. Saunders emphasized the importance to the Pennsylvania of the decision which it must make and requested that he be informed whether the Government intended to continue to oppose the Penn-Central merger under all conceivable circumstances. He indicated that the Government's attitude would have an influence on the Pennsy's decision as to divestiture.

After considerable discussion of the matter I informed Mr. Saunders that since we had only recently reviewed our position of opposition to the merger, had concluded on the merits that we should continue to oppose it, had publicly reasserted that opposition, and the case is now under submission to the hearing examiners, it would be inappropriate to take any action to the contrary at this time. As to the future, I pointed out that my further tenure as Attorney General would be quite brief and that I could make no commitment which would bind my successor in office as to views on the proposed merger.

I did tell Mr. Saunders that I would inform my successor by memorandum which I would place in the Department files that, if the hearing examiners' recommended decision should be contrary to the Government's position and favorable to the merger and the merger applicants have by that time formulated terms for inclusion of the New Haven in the proposed Penn-Central system which are satisfactory to the New Haven's trustee and to the District Court, then unless circumstances have materially changed it would be my recommendation that the Department of Justice not continue opposition to the merger beyond that point. Mr. Saunders indicated that this information would be helpful to him and his Board of Directors in reaching a decision on the divestiture question.

SEPTEMBER 9, 1964.

Hon. NICHOLAS deB. KATZENBACH
Acting Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. KATZENBACH: This acknowledges your letter of September 4 with copy of a memorandum which Mr. Robert F. Kennedy placed in the files of the Department of Justice while he was Attorney General with reference to the Department of Justice's position on the proposed merger of the Pennsylvania and New York Central Railroads.

As I stated to you on the telephone yesterday, the memorandum seems to make inclusion of the New Haven Railroad in the proposed Penn-Central system an absolute condition to withdrawal of the Department's opposition to this merger. It also states that terms for inclusion of the New Haven in the proposed system must be satisfactory to the New Haven Trustees and to the District Court and that they must be formulated by the time of the Examiners' recommended decision. This is not in accordance with my recollection of what took place at our conference.

It was agreed, as I recall, that we would diligently seek to find a fair and reasonable basis to include the New Haven in the proposed system and that we would keep Mr. William Orrick informed as to the progress which we are making. This, however, was not to be an absolute condition and such action did not necessarily have to be taken prior to the date that the Examiners filed their report.

You stated that it was neither the intention of Attorney General Kennedy nor of yourself that inclusion of the New Haven should be an absolute condition. You said that both of you considered the matter of its inclusion as one of great importance. It was not contemplated, as I understand it, that if the Trustees of the New Haven were unreasonable or if terms could not be found that were mutually fair to the security holders of both companies, that its inclusion would be mandatory.

If what I have said is not in accordance with your understanding, won't you please let me know.

Sincerely,

(Signed) STUART T. SAUNDERS.

JANUARY 14, 1965.

Hon. NICHOLAS deB. KATZENBACH,
Acting Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. KATZENBACH: Mr. Perlman and I were glad to have an opportunity to meet with you and Mr. Orrick in your office on January 8 and to bring you up-to-date on the proposed Pennslvania-New York Central merger, and particularly the present status of our negotiations with the Trustees of the New Haven Railroad.

I was glad to hear you say that the Department of Justice is adhering to the position stated in your letter of September 4, 1964, to me and the attached memorandum which the Honorable Robert F. Kennedy placed in the Department's files in this connection. We

assume, of course, that this also includes the clarification of the memorandum which was set forth in my letter of September 9 to you.

Respectfully,

(Signed) STUART T. SAUNDERS.

JANUARY 14, 1965.

Mr. WILLIAM H. ORRICK, Jr.,
Assistant Attorney General in Charge of Anti-Trust,
Department of Justice,
Washington, D.C.

DEAR MR. ORRICK: Mr. Perlman and I appreciate very much the opportunity to meet with the Honorable Nicholas deB. Katzenbach and yourself in his office on January 8 and to give you current information as to our negotiations with the New Haven.

We were pleased to hear Mr. Katzenbach state that the Department of Justice adheres to the position which was stated in Mr. Katzenbach's letter of September 4, 1964, to me and the attached memorandum of the then Attorney General, the Honorable Robert F. Kennedy, which was placed in the Department's files in this connection. We assume, of course, that this also includes the clarification of the memorandum which was set forth in my letter of September 9, 1964, to Mr. Katzenbach.

Respectfully,

(Signed) STUART T. SAUNDERS.

APRIL 22, 1965.

Hon. NICHOLAS DEB. KATZENBACH,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. ATTORNEY GENERAL: I was grateful for the opportunity to meet with you and Mr. Orrick on Monday and to inform you of developments with reference to our Penn-Central merger, particularly as related to the New Haven Railroad, which have transpired since our last meeting.

As I explained to you, we have worked out a memorandum of understanding with the Trustees of the New Haven which is mutually satisfactory and which has been submitted to the Federal District Court in which the New Haven's bankruptcy proceeding is pending. I sent a copy of this memorandum of Mr. Orrick several days ago.

We are now in the process of preparing a definitive agreement reflecting the terms of the memorandum, and as soon as it is completed and executed, it will be filed with the bankruptcy court for its approval. Assuming that the court approves this contract, we believe we will have complied with the memorandum which Attorney General Kennedy placed in the files of the Department of Justice shortly before his resignation and which you sent me with your letter of September 4, 1964, in which you said that you were in agreement with his conclusions.

You will recall, as the memorandum shows, that based upon this understanding the Pennsylvania agreed to the condition in the order of the Interstate Commerce Commission in the Norfolk and Western-Nickel Plate-Wabash consolidation case to divest itself of all of the Norfolk and Western stock which it then held as well as that which it will receive in connection with the sale of the Wabash to that new system. All told, this commitment involves some 425 to 450 million dollars. This understanding also was, of course, a controlling consideration in our determination not to appeal the decision of the Commission in the Norfolk and Western case.

I understand that your Department is now reviewing the Examiners' proposed report in the Penn-Central case and that if you have any questions about it, you will give me an opportunity to talk to you regarding them. In the meantime, I will keep you and Mr. Orrick informed of any developments. If either of you desire any additional information, please let me know.

Respectfully

(Signed) STUART T. SAUNDERS.

EXHIBIT 68

PENN CENTRAL,
October 14, 1969.

J. H. BURDAKIN
E. P. FRASHER
R. C. HARRISON
F. S. KING
R. F. LAWSON
J. M. MCGUIGAN
W. B. SALTER
G. M. SMITH
K. E. SMITH

Subject: Master Operating Plan Progress Appraisal

Each of you recently received a copy of the Master Operating Plan which outlines in considerable detail operating adjustments, proposed capital expenditures, and other steps for the consolidation of our operational property during the first five years of merger. Some

of these have already been carried out. Others will be implemented in the next few years. I realize that in many instances there have been deviations from these plans, and that probably others will be necessary since the Railroad's complexion changes almost daily. However, this Plan is basic for operating the Company and I intend using it as a foundation for the development of a "3-Year Plan" which will include the Operating Department's short-range objectives, the means of attaining them, and delineate the long-range objectives as guidelines.

With this in mind, I would like you to immediately commence a critical review and analysis of the Master Plan, with particular reference as to how it affects your Region. For example, what progress has been made? What steps yet remain to implement the Plan? Or, alternatively, what other effective plans (or variations of Master Plan items) or projects can you propose? Of course, you must give thought to the achievements you would like to have your Region accomplish by 1973 or '74.

We must start looking to the future—where we are going and how we are going to get there.

You should be able to discuss this evaluation appraisal by November 15, 1969.

I have asked Mr. Schofield to coordinate this activity and expect that his office will be in contact with you concerning this matter.

R. G. Flannery,
Vice President—Operation.

To: E L. Claypole
G. C. Vaughan

I expect you to play an active role in this assignment.

R. G. Flannery.

To: A. M. Schofield

Be guided accordingly.

R. G. Flannery.

Exhibit 69

Ardmore, Pa., *May 15, 1972.*

Mr. Robert L. Oswald,
Secretary, Interstate Commerce Commission,
Washington, D.C.

Dear Sir: It was agreed at the meeting which I had on January 27, 1972, with Mr. George K. Deller and Mr. Thomas J. Russo of the Interstate Commerce Commission's Bureau of Accounts, that I would submit a memorandum covering some of the points we discussed. Subsequently, my attorney received a letter from Mr. James R. Taylor, Trial Attorney for the Commission's Bureau of Enforcement, stating that the Bureau would prefer that my comments on my testimony and the Bureau's brief be submitted to the ICC rather than with Mr. Deller's statement. It was agreed that the Bureau would not raise any objection to my filing such a statement on or before May 15, 1972. Accordingly, I submit the following comments:

On page 2 *et seq.* of the Bureau's brief, it is stated that the respondents to Docket No. 35291 are Penn Central Transportation Company ("PCTC"), Penn Central Company ("PC") and Pennsylvania Company ("Penneo"). I am not a party to that proceeding nor have I ever received or seen any of the orders entered in that proceeding. It was not until I received the Bureau's brief that I was informed of any right to cross-examine persons who filed verified statements.

"MAXIMIZATION OF EARNINGS"

To my knowledge, the phrase "maximization of earnings" was first used by Mr. David C. Bevan in his memorandum to me, dated November 21, 1966, in which he said: "The policy may be instituted of maximizing earnings within *the limits of good accounting practices.* In the last several years this has been done in accordance with your expressed desires." (emphasis mine).

The phrase "maximizing earnings" was Mr. Bevan's, not mine. In fact, I do not recall ever using it and I paid no particular attention to this expression in his memorandum as I am not aware of any such policy. All matters relating to earnings were handled on a case-by-case basis. If I ever used the phrase, it was in the context as Mr. Bevan stated "within the limits of good accounting practices" or, as more customarily stated, "within the limits of generally accepted accounting principles". All PC officers as well as those of its predecessor, The Pennsylvania Railroad—and officers of their principal subsidiaries knew that this was our controlling guideline. I know of no instance in which this was not observed.

I always insisted that all transactions involving earnings of PC and its subsidiaries be approved by Peat, Marwick, and Mitchell ("PMM") and by appropriate financial, accounting and legal officers of PC or PCTC, as the case may have been, as well as by outside counsel where any such advice was deemed appropriate. Similarly, prior to the merger of the New York Central ("NYC") and the Pennsylvania Railroad, I followed the same procedure, except that PMM were not the outside accountants for the Pennsylvania Railroad until February 1, 1968. The books and accounts of the Pennsylvania Railroad, NYC and PC were subject to almost constant review by the ICC Bureau of Accounts both before and after February 1, 1968. Even before that date, PMM made studies of accounting procedures of the Pennsylvania Railroad and its subsidiaries and they were also the outside auditors for a number of years before 1968 for many of the Railroad's principal subsidiaries (e.g., Great Southwest Corp., Buckeye Pipeline, Macco and Arvida).

In addition, I insisted that the appropriate Boards of Directors be informed of all transactions involving earnings and that the appropriate Boards approve all such transactions. I am not including the New York Central transactions prior to the effective date of the merger as I had nothing to do with them.

In no case—prior to or after the merger—did I ever overrule our accountants, either internal or external. I always insisted that we observe generally accepted accounting principles and the principles and practices of ICC accounting. There were instances where accounting treatment under ICC accounting rules and practices differed from the accounting principles of the Accounting Principles Board. These differences were always brought to the attention of the ICC, and where generally accepted accounting principles were followed rather than those of ICC accounting, they were footnoted in our Annual Reports to Stockholders.

My view on earnings always was—and I think this is the duty of any chief executive officer—to improve earnings by cutting costs where that could be done without sacrificing service; to improve operating efficiency of the Railroad and its subsidiaries; to improve traffic volume; to cut overtime, per diem and inventory; and to improve our cash position through better billing and sale of scrap (both equipment and rail). This represents the only concept I ever had of so-called "maximization of earnings". I always thought of it in terms of improving our earnings within generally accepted accounting principles whether those principles be the accounting principles of the Commission or of the Accounting Principles Board.

This philosophy also applied to PC's subsidiaries, although I did not have the same day-to-day contact with the subsidiaries as I had with PC and PCTC. My contacts with the officers of the subsidiaries was very occasional and was usually in very brief telephone conversations. I would call them to get information as to how they were doing, what their prospects were and to check information that I was getting from other sources. These affairs were handled primarily by their independent directors and officers or by our financial department.

The same careful review procedures mentioned above with relation to our financial statements were also uniformly followed in the preparation and release of news releases. I never prepared news releases, but I always insisted they be reviewed by financial, accounting and legal officers of PC or PCTC, as the case may have been, or their respective subsidiaries.

DIVERSIFICATION

The diversification of PC and its predecessor companies started many decades ago. Overall, this program should not involve any dissipation of assets in investments made since 1963. The impression has been created that the diversification program was started in 1963 and that large sums of money have been lost by virtue of it. These statements are inaccurate.

The Pennsylvania Railroad Company was chartered under the laws of Pennsylvania in April 1846, and that company operated all the lines of the railroad and held its investments until April 7, 1870, when Pennco was incorporated under the laws of Pennsylvania. At that time, the Board of the Pennsylvania Railroad decided to place its rail lines in two separate operating companies. The lines east of Pittsburgh were placed under the operation of the Pennsylvania Railroad. The lines west of Pittsburgh were placed under the operation of Pennco. As consideration for the transfer of the lines and assets west of Pittsburgh, Pennco issued to the Pennsylvania Railroad all of its capital stock, having a par value at that time of approximately $8 million. Today, the Railroad's successor, PCTC, still holds all of the equity stock of Pennco.

During the period 1870 to 1918, Pennco acquired stock in a number of other railroads, including the Norfolk & Western Railway, as investments. During that period of time, Pennco actually owned as much as 43% of the outstanding stock of the Norfolk & Western, and today, to the best of my knowledge, Pennco still owns approximately 1.4 million shares, or approximately 14%, of that company's outstanding stock.

Around 1918, the Board of the Pennsylvania Railroad decided that all of the operating lines of both the Pennsylvania Railroad and Pennco should be placed in the Pennsylvania Railroad. This was done with the hope that improved operating efficiency would result. Thereafter, the Pennsylvania Railroad became primarily the operating company and Pennco an investment company. In the years that followed, Pennco, functioning in its role of an investment company, acquired almost 100% of the outstanding stock of the Detroit, Toledo & Ironton and Ann Arbor Railroads, the Wabash Railroad, and a controlling interest in the Lehigh Valley Railroad. Today, it still holds all of these investments, except that stock of the Wabash which was exchanged in 1970 for Norfolk & Western stock pursuant to an order of the ICC.

Beginning in January 1963—some ten months before I came to the Pennsylvania Railroad—Pennco began acquiring substantial holdings in the Buckeye Pipe Line Company, which operates some 7,000 miles of pipeline through the eastern part of the United States, and within a relatively short period thereafter Pennco had acquired all of the common stock of Buckeye. During the period 1964–1966, Pennco acquired controlling interests in Arvida Corporation, Great Southwest Corporation and Macco Realty Corporation. It still holds these investments.

In addition, for the last 100 years the Pennsylvania Railroad has owned all of the outstanding stock of Manor Realty Company and American Contract Company, both of which are investment companies. American Contract Company was incorporated in 1871 and Manor Realty in 1870. These companies were used to acquire securities; real estate

for development such as industrial sites and coal lands; and interests in trucking lines, all involving several hundreds of millions of dollars in non-railroad investments. These companies are still in existence and have held substantial investments of the type described through the years.

Therefore, the notion that the Pennsylvania Railroad and Pennco only started diversifying in recent years is wholly unfounded. The nonrailroad investments of these companies have always been used to support and supplement the railroad operations through dividends, advances, development of industrial sites and use of their credit as a basis for financing.

Similarly, NYC's non-railroad investments have, over the years, poured millions of dollars into sustaining the railroad operations of that company. For example, the Realty Hotel Corporation which was formed as a wholly owned subsidiary of NYC, acquired five large hotels in the Grand Central Terminal area of New York City beginning in the 1930's. Moreover, NYC had substantial air rights (some 29 acres all told) in this area on which have been developed office buildings such as Pan Am, Union Carbide and the American Tobacco office buildings. These properties have produced millions of dollars in income each year, most of which was generally paid up as dividends to the parent company, NYC, and since the merger, PC. In 1969 alone, income from these non-railroad investments benefited PCTC by more than $20 million, all of which was used for railroad purposes.

Similarly, over the years, these investments in non-railroad activities have been used to raise millions of dollars for railroad operations. For example, through these investments PCTC was able to raise $84 million in 1969, and the credit of Pennco was used to borrow an additional $200 million from banks in 1969 and $100 million in 1968. These funds were used to sustain the operations of the railroad.

The statement in the Bureau's brief, at page 113 *et seq.*, to the effect that: "Penn Central's diversification into non-railroad activities occurred basically before the 1968 merger and after 1963" is simply not correct. The above statement detailing the history of the diversification of the Pennsylvania Railroad, Pennco and NYC is ample proof to the contrary. The Bureau's brief simply overlooks the fact that the non-railroad investments of these companies were their only productive assets and over a long period of years produced millions of dollars of income to sustain the operation of the railroads.

The basic policy of PC and its predecessors was to use funds of its subsidiaries for investments in companies which we believed would produce the highest return and which would provide additional funds and credit for operation of the railroad. In considering the investment program of PC and its predecessors, it must be remembered that they had large tax shelters and that, by acquiring companies which were making money, their earnings could in many cases almost be doubled by using these tax shelters.

Another concept was that our diversification should be in areas where these railroads had been traditionally involved and where its officers had expertise. Real estate was one such area and hence our investments in Great Southwest, Macco and Arvida. Transportation diversification—not just railroads—was also considered a field for investment if it could be done legally. I have always believed in the concept of integrated transportation. That is to say, that railroads can do some things more efficiently and economically than highways, waterways or airways and this led us into pipeline operations—Buckeye Pipeline—and air taxi service—Executive Jet Airways.

PC has not been unique in investing in non-railroad businesses and properties. For many decades prior to 1963, many roads such as the Norfolk & Western, C. & O. and Union Pacific invested in coal, oil, other minerals and non-railroad real estate. The decision of the ICC in the PC Merger Case (327 ICC 475, 1966) said:

"Certain of the protesting parties also point to the large non-transportation investments made by applicants in the recent past and assert that the availabiliy of funds for such investments does not indicate dire financial straits. One answer given is that in a free enterprise system, management is expected by stockholders to place available funds in investments that will bring a rate of return commensurate with the risk involved. Applicants' managements have made such nontransportation investments (as have other railroad managements), to offset the low return on investment in transportation property and because such action was dictated by their experience in business recessions since World War II. at which times applicants' income from non-transportation investments made the difference between loss and profit. In the case of NYC, such 'other income' was possibly the final bulwark against insolvency."

In 1960, the Bangor Aroostook formed the first railroad holding company. Between 1960 and 1970, at least 12 or more railroads formed parent holding companies. Today, the assets of these holding companies represent over one-half of the total assets of the railroad industry and over 120,000 miles of the nation's 200,000 miles of rail lines are under the control of railroad holding companies. Among the holding companies are Illinois Central Industries which has in recent years invested some $320 million in such activities as panty hose, root beer, Pepsi Cola bottling, etc.; Chicago Northwestern has put several hundred million dollars in such industries as the chemical, steel and rubber industries; also Katy Industries, Kansas City Southern Industries, Southern Pacific, Seaboard Coast Line, and Santa Fe have made large investments in non-railroad enterprises.

At page 8 of Mr. Russo's Verified Statement No. 4, he states: "The investigation included a review of the cash impact on the carrier from its investments in non-railroad related industries. This review encompasses the period from 1965 to June 30, 1970, and includes the Pennsylvania Company as well as the Pennsylvania Railroad, and New York Central (Penn Central after February 1, 1968). The Pennsylvania Company (Pennco)

is included because it was a railroad related company whose holdings included primarily railroad securities and lessors of Pennsylvania Railroad, which holdings could not be divorced from the parent. Prior to 1963, Pennco's holdings in non-railroad activities were negligible. For purposes of this review, Pennsylvania Railroad, New York Central, and Pennco were regarded collectively as one.

"The results of the study illustrated in Exhibit DN–L annexed hereto show the diversification program resulted in a net cash loss to the carrier of $153 million during the study period."

The statement that Pennco is included because it was a railroad, related company whose holdings included primarily railroad securities and lessors of the Pennsylvania Railroad cannot be supported. It overlooks Pennco's investments in Great Southwest, Arvida and Buckeye, to mention only a few. It is quite clear that this assumption was made because only in this way could any alleged cash drain from the Railroad have been shown.

One other aspect of the diversification program that must be taken into account is the order of the ICC that Pennco should divest its holdings in the Norfolk & Western within 10 years beginning in 1963. The fact is that a substantial portion of the funds used to acquire interests in Great Southwest, Macco, Buckeye and Arvida came from the $65 million realized from the sale of the Long Island Railroad, on which the Pennsylvania had had no return since 1930, and from the proceeds of the sale of Norfolk & Western stock.

It is difficult to ascertain what the rationale is between so-called railroad and non-railroad investments. Many of Pennsylvania Railroad's and Pennco's investments in other railroads were failures. Take, for instance, Pennsylvania's investments in Lehigh Valley, Ann Arbor, Long Island and the Pennsylvania Reading-Seashore Lines. All of these investments resulted in heavy losses and all of these investments were made long before I came to the Pennsylvania. For example, in 1933, the Pennsylvania Railroad made an agreement with the Reading Company to operate jointly the Pennsylvania-Reading Seashore Line. From 1933 to December 31, 1969, the Pennsylvania Railroad, and later PC, made up losses of $92 million in cash. This situation was studied many times, but no way was ever found under which this agreement could be legally terminated.

If you take into account imputed interest over the period of these investments, the Pennsylvania Railroad lost many times more on its railroad investments than Penn Central may lose on the non-related railroad investments mentioned above. Most of the railroads in which the Pennsylvania Railroad made investments are now bankrupt or worthless. On the other hand, none of the non-railroad companies in which investments were made since 1963 are bankrupt. In fact, taking these investments as a whole, it is highly unlikely that PC will lose any money on them and it is quite likely that it will make a great deal of money on these investments. For instance:

(1) Buckeye Pipeline is a sound investment. In my judgment, PC's investment in this company is now worth many millions of dollars more than was paid for it.

(2) Arvida Corporation. Pennco has an investment of about $22 million in this property. Based on the current market value of Arvida stock, Pennco's investment is worth more than $50 million.

(3) Great Southwest. Pennco has an investment of approximately $92 million. It owns approximately 23,747,000 shares of this company's common stock as well as a very substantial amount of its preferred stock. On the basis of current market prices for the common stock, Pennco's investment is worth approximately $55 million. It is my opinion that if fire sales are not made, the Great Southwest investment can turn out to be quite profitable.

(4) Executive Jet Aviation. While I do not condone some of the things that I have learned in recent years regarding PC's investments in EJA, the original concept of EJA was sound and this company could and may still become very successful.

The recession of 1969–70 and the tight money market during that period certainly had adverse effects on these companies, especially Great Southwest and Arvida. In Great Southwest's case, the reorganization of PC dried up practically all of its markets for financing.

REASONS FOR PCTC'S PETITION FOR REORGANIZATION

The following are some of the reasons why PCTC, in my opinion, was forced into reorganization under Section 77. The basic reasons for this reorganization were beyond our control and by and large they involved problems not of mismanagement, but problems which were unmanageable.

First, let me outline the magnitude of the problems with which we were confronted. The railroad industry has been an ailing industry for years. Not only have the Pennsylvania, the New York Central, and the New Haven, as separate railroads, and the merged PC been beset with the problems of this ailing industry, but in most cases they suffered from those problems much more acutely and they also had other problems not common to the industry generally.

The railroad industry and PC in particular were hit very hard by the 1969–70 recession, inflation, tight money and high interest rates. I stated in our Annual Report to Stockholders for 1969 that inflation had cost PC approximately $100 million in that year alone.

Another adverse factor was the spiraling cost of operating the railroad. In 1969, our level of labor costs increased 7 per cent, or $74 million, which was on top of a 9 per cent increase in labor costs in 1968, or $90 million. In 1970, this trend continued. Our material costs also rose 5 per cent in 1969, or $9 million. In 1969, our fixed charges, which were mainly interest costs, increased by $34.8 million and in the first quarter of 1970, they were up an additional $9 million, or at an annual rate of about $36 million.

The 1969–70 recession also contributed heavily to the PCTC's entry into reorganization. Railroads are among the first to feel the impact of downturns in the economy and this is especially true of PC because of its heavy dependence on automobile, steel and general merchandise traffic. The recession cost PC many millions of dollars in 1969 and this continued in 1970 in terms of both revenues and earnings.

Most people don't realize how far freight rates charged by the railroads were out of line and how little they offset the effects of inflation and steadily mounting operating costs. The fact is that even with the freight rate increases which were granted in 1968 and 1969, freight revenues per ton-mile were actually lower than they were in 1958. On the other hand, during the same time PC's labor cost per hour worked had risen 65 per cent. The railroads themselves were in good part responsible for failing to secure adequate increases in their charges. But, this failure was not the fault of management of PC.

Generally speaking, freight rates are not within the control of individual railroads. There must be agreement on joint rates which exist throughout the country and on the level of competitive rates. From time to time, PC did give consideration to a regional approach for increasing freight rates, but due to conditions prevailing at the time we concluded that such an approach would not be effective, especially because of the delay involved. For instance, take what happened to the proposed 6 per cent increase filed with the ICC on March 3, 1970. For months prior to that time, PC tried to persuade the railroads to file an application for an increase with the Commission, but certain key railroads would not even discuss an increase. Finally, they agreed to consider it. PC, along with a number of other railroads, wanted to ask for a 12 percent increase. Such an increase would have meant some $150 million in income for PC as it paid no Federal income taxes due to large losses on its railroad operations. A number of railroads, however, would not go along with a 12 per cent proposal and something under 5 per cent was tentatively authorized by the Commission as of June 9, 1970. This was less than half of what PC had originally advocated.

In addition to the inadequacy of the freight rate increase which was requested, and the several months consumed by the railroads in trying to decide what increase they would seek, several more months were consumed by the Commission in processing the case for decision. Time lags like this are very costly to the railroads. Each month of delay on say a 6 per cent increase deprived PC of about $7 million in revenues.

The case which I have just cited is not an isolated one. This same pattern was involved in every freight rate increase proposed in the three years before 1970 and cost PC well over $125 million.

Freight rate increases are never granted retroactively, but it has been the practice for many years to make retroactive increases in wages in the railroad industry. For example, in 1969 the wage increases granted during the year totalled some 7 per cent and were retroactive to January 1, 1969. They amounted to $74 million on PC, but no freight rate adjustment was made effective until 10½ months later which meant that PC actually received only $7.6 million from the rate increase in 1969 to apply towards a full year of increased operating costs.

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In considering the causes of PC's filing its petition for reorganization, the winter of 1970 must be remembered. It was the worst winter of record in the 20th century. PC was practically paralized for three weeks or more. From the point of view of cash, operating expenses and revenues, it was much worse than a strike. On a conservative basis, the 1970 winter cost PC some $30 million. As a result of this and other factors, PC had in the first quarter of 1970 an operating loss of about $56 million after certain credits and a loss of $100 million before such credits.

* * * * * * *

Another factor in bringing about PC's financial crisis was its passenger deficit. This was an intolerable burden. In 1969, PC had 35 per cent of all the passenger service in this country and 64 per cent of it in the East. Even though PCTC effected economies of $29.2 million in passenger operations during 1969, it still had a passenger deficit of $104.8 million on a fully allocated basis and some $60 million on an out-of-pocket basis. No management, I submit, could cope with the problem of starting out each month with a loss of $5 to $8 million, depending on how you calculate it.

This passenger deficit problem was also greatly aggravated by the fact that the United States Post Office Department diverted a very substantial portion of mail to the air and highways which reduced PC revenues between 1967 and 1969 by $24 million annually or about 30 per cent even though the volume of all United States mail increased greatly during that time. Not only did PC suffer a big loss of revenue, but it had either to carry approximately 1,000 employees on its payroll who were engaged in handling mail or give them severance pay. A large part of PC's investment in equipment for handling mail, likewise, became worthless.

Besides the economies which were accomplished in our passenger service in 1969 of $29.2 million, we had pending in May 1970 applications for abandonment of 46 trains. These discontinuances would have meant out-of-pocket savings to PC of approximately $23 million on an annual basis. In an effort to deal with this problem, PC had been following a two-pronged approach. Its position was that either we should be permitted to discontinue trains of this type because of the heavy losses which their operations entailed, or if it were found that they should be continued in the public interest but without paying their own way, then the deficit should be met by government aid of the type provided in the Amtrak legislation.

With regard to commuter service, we had been working for over a year prior to 1970 with state authorities in New York and Connecticut on arrangements whereby portions of the New Haven Railroad and the Harlem and Hudson Divisions of the New York Central Railroad would be acquired by the transportation authorities in those states and would be operated on a no-loss basis by PC for their account. Such arrangements would have been mutually advantageous to the traveling public and PC. These arrangements would have made it possible for the states, with Federal aid, to invest over $125 million in new equipment and facilities for commuter service. This was the only way by which the public could receive the type of commuter transportation that was needed in these areas.

Discussions had also been initiated looking to similar arrangements for commuter service in the New Jersey, Philadelphia and Boston areas.

I mention these arrangements to show what PC had done in order to try to deal with this passenger deficit problem. While considerable progress was made, practically none of these plans had come to fruition as of June 21, 1970. These plans, of course, would be highly beneficial, but would by no means solve PC's overall problems. The Trustees of PC are following the same approach to this problem.

* * * * * * *

Another factor that played a major role in PC's financial condition, especially its cash problems, was its heavy merger start-up costs. Between February 1, 1968, the date of the merger, and December 31, 1969, these costs amounted to a net of $193,023,657, after taking into account merger savings of $73,922,807 realized during that time. Among the principal items of these costs were employee severance and protection payments and transfer and relocation costs which totalled $64,718,216. (See discussion *infra* on Labor Agreement). There were also expenditures of $121,162,000 for property improvements which were necessary to implement the merger, of which $75 million were for yard projects. Most of the merger connected projects of this sort were completed prior to June 21, 1970.

While these expenditures will pay handsome dividends in later years, on a short term basis they reduced PC's cash and many of them had a sharp impact on railroad operating expenses and financial results.

The fact is that between February 1, 1968 and March 15, 1970, PC reduced the number of its employees by 8,410 and approximately 500 of these were officers and supervisory employees. The reduction of one employee meant an average saving of more than $11,000 after the first year following severance. Thus reducing employment by 8,410 means recurring savings on an annual basis of more than $90 million.

While not a part of merger start-up costs, it should be pointed out that during 1968 and 1969, PCTC spent $600 million on railroad equipment and facilities or more than 10 percent of the total amount invested by the entire railroad industry.

Finally, the requirement that PC include the New Haven into its merged system imposed additional financial burdens on PC. The New Haven had a deficit of $22.3 million in 1968, which was the year prior to its inclusion in PC.

All of these factors aggregate millions of dollars and would have made a tremendous difference in PC's financial results.

These are some of the problems with which the management of PC had to contend; many of them involved factors over which the management had little or no control.

As confirmation of my opinion that the problems of PC were problems beyond the control of management—problems which were basically unmanageable and not mismanagement, I quote the following from the "Preliminary Report of Trustees Concerning Premises for a Reorganization" which was filed with the U.S. District Court for the Eastern District of Pennsylvania on February 10, 1971:

"But despite the solid progress already made and planned for PC's recovery a great deal more is needed before this giant property can become viable. *For it is a fact that PC is presently locked by circumstances beyond managerial control* into a situation which had best be recognized *now* as completely precluding viability unless certain constraints are removed, or other arrangements are made to compensate for their effect." (page 2)

"But, the overriding problem of PC remains—the problem that must be overcome if it is to stay in the private enterprise system. It is found in an obligation to perform as a public service company in certain areas and under certain conditions which simply do no lend themselves to profitable operations, *no matter who the operator is, or how efficient.* The only possible remedy here is for public authority to lend its hand to a speedy elimination of the conditions which produce the losses, or respond with adequate compensation, if it insists upon continuance of the conditions." (page 15) (emphasis mine)

I repeat that, in light of the problems which I have enumerated, the situation on the PC was not one of mismanagement but one of unmanageability.

INFORMATION AS TO PC'S FINANCIAL PROBLEMS

I would like now to discuss what was done to bring the PC's problems to the attention of the appropriate governmental officials and others, and what management tried to do about them.

For a long time prior to June 21, 1970, I had been discussing these matters not only with the ICC, appropriate committees of Congress and governmental officials, but I had also discussed them publicly on many occasions.

In 1965, (I do not have the exact date or transcript of the proceeding, but they are in the record of the proceedings before the ICC in the N. & W.–C. & O.–B. & O. merger) I said, in substance, that if the proposed PC merger resulted in a giant, it would be in a physical sense only, but financially it would be a toothless giant with no financial bite.

On April 23, 1968, I spoke to the Commerce and Industry Association of New York where I stated:

"As a private enterprise, however, we cannot continue to provide passenger service at substantial losses. In 1967, PC's passenger deficit was $85.3 million, of which $12.7 million resulted from commuter service, even though we received considerable public assistance. PC has demonstrated its eagerness to join with public and governmental agencies in coping with this transportation problem. But the solution requires the mobilization of resources beyond the combined capacity of railroads, localities, and states. The need is evident for much greater Federal participation than has been available in the past. Even in these times of unprecedented prosperity, our industry's rate of return last year was only 2.45 percent, and for the Eastern lines 1.58 percent. *No industry can live, much less modernize, on such a low rate of return.*" (emphasis mine).

In a speech before the New York Traffic Club on February 20, 1969, I made the following comments on the possibility of nationalization of the railroads:

"The decline of railroad passenger service is a familiar story. The railroads were simply pushed out of the passenger market by the automobile and the airplane. A parallel to this situaion, in my judgment, is developing with the growth of air cargo transportation. In less than a decade, air freight shipments in the free world have jumped from approximately 600 million ton miles to an estimated 9 billion ton miles last year—a 15-fold increase. Indeed, I predict that unless the railroads are permitted to diversify into other forms of transportation, within a relatively short period of time air cargo will have the same effect on railroad freight traffic as passenger airlines have had on long-haul and intermediate-range railroad passenger service since World War II. The impact of airborne freight could be the last straw for railroad freight service except bulk commodities, and railroads cannot survive on this sort of traffic alone. This imminent new threat underscores the need for the revision of laws and regulatory practices which prohibit railroads from ownership of other modes of transportation. *Without such a change, I see no alternative to nationalization of our railroads in the not too distant future.*" (emphasis mine).

All of these comments were widely publicized.

On September 25, 1969, I appeared before the Senate Commerce Committee in support of S. 2750 which had been introduced by Senator Hartke for the purpose of providing Federal aid to rail passenger service. During the course of the hearing, the following colloquy took place between Senator Cannon and me:

Senator CANNON. "Having listened to his testimony (Mr. Reginald Whitman, Railroad Administrator, U.S. Department of Transportation) would you feel that the study that he is covering would be of help in trying to get at some of the root problems of this issue? I note that some of your recommendations generally cover some of the areas that appear to be covered in the study."

Mr. SAUNDERS. "Well, I think the study will be helpful, but let me say this: In the first place, as Senator Allott said, this matter has been studied to death. . . . I don't think that there is an appreciation of the sense of urgency involved in this thing. I think you have to look at it from a short-range standpoint and a long-range standpoint. The study will be fine from a long-range standpoint. But I think that what this committee, if I may say so respectfully, and what the Department of Transportation must realize is that *this house is on fire now, and it has been on fire for some time . . .*" (emphasis mine).

Senator CANNON. "*Well, you make a very persuasive case. I may say that you indicate the house is burning down.*"

Mr. SAUNDERS. "*It is afire . . . what has to be done is this patient has got to have an infusion now. And further infusions in a long-range program.*" (emphasis mine).

"Let me say this to you, that I don't think there is sufficient appreciation *of the dire situation in the railroad industry. I am not talking about passenger trains alone, I am talking about the railroads generally. The railroad industry of this country is sick. And it is sick because they can't make enough money to live on.* The railroads of this country last year had a rate of return of 2.4 percent, about half of what a government bond pays. Now AT & T is making over 7 . . . around 8 percent now, of return. And they are presenting a case to the Federal Communications Commission saying that they have to have 8½ to 9 percent after taxes in order to live and modernize . . . *There is no industry in this country that can live on a 7½ percent return.* Or can modernize. *This passenger situation is only one of the symptoms. The whole situation is deteriorating.* . . . We don't have the financial resources to do the job we ought to do. *The passenger situation is only one segment of it. . . .*" (emphasis mine).

This colloquy took place between Senator Hartke and me at that hearing:

Senator HARTKE. "I have been out on these roadbeds myself and I am not an expert in engineering, but it doesn't take an expert to know they are in bad shape."

Mr. SAUNDERS. "They are not in the condition that they ought to be. The railroads of this country are being starved to death, we haven't got the money to put into the property we ought to." On November 12, 1969, I testified before the Subcommittee on Transportation and Aeronautics of the House Committee on Interstate and Foreign Commerce to this effect:

"You have before you, in my judgment, a two-pronged problem. *The first is the urgency for immediate relief, even if it is short-term and stopgap. Our problem cannot wait another year or even another few months. This house is on fire, and we cannot sit around and talk about the best way to put it out while it burns completely down. . . . Time is of the essence.*

"I respectfully submit that there is not sufficient understanding of the plight of the railroad industry. *Passenger service is only the most obvious symptom of the perilous condition of our industry.*" (emphasis mine).

My statement to this Committee was printed and a copy of that printed statement was sent to every member of Congress and the editorial page editors of leading newspapers.

On February 24, 1970, Mr. Paul A. Gorman, then our President, and Mr. Jonathan O'Herron, then our Vice President, Finance, and I met with members of ICC and certain members of their staff. We went over in detail our 1968 and 1969 financial results, for both the consolidated and transportation companies, the source and application of funds for 1969, our projections for 1970 and our financial plans for 1970.

During February and prior to March 13, 1970, I had at least three meetings with Secretary Volpe in which our problems were discussed. On March 13, 1970, Mr. Gorman, Mr. O'Herron and I had a full discussion of our problems with Secretary Volpe and his top aides and made substantially the same presentation that we had made on February 24 to the members of the ICC. Secretary Volpe and his aides agreed that we should get in touch with them again as soon as we had a better picture of PC's financial results for the first quarter of 1970. There was no discussion with Secretary Volpe at that time about a Government-guaranteed loan a PC's financial department believed then that it would be able to meet the Company's needs through private financing.

As soon as figures regarding PC's first-quarter earnings for 1970 were available, I sought a further meeting with Secretary Volpe and his top aides, and a meeting was held on April 30, 1970. Secretary Volpe stated that he would discuss our financial problems with other governmental officials and especially with Secretary Kennedy of the Treasury Department. Secretary Volpe arranged appointments for me to see Secretary Kennedy at which time I explained the problems with which PC was faced.

For some time, our financial people had been working on a $100 million debenture issue by Pennco which they planned to market in the latter part of May. In this connection, see the remarks of Mr. Bevan at the Annual Meeting of Stockholders on May 12, 1970, and his statement in the *Wall Street Journal* on May 15, 1970 to the effect that the financing would be consummated. On May 28, 1970, however, our financial officers and the underwriting group concluded that the sale of this issue should be postponed and on that date, PC made a public announcement to that effect.

The Company was also exploring other methods of financing. One of the alternatives considered was a government-guaranteed loan, and a number of discussions and conferences were held with governmental officials in that regard. As a result of these meetings, a plan was developed for a government-guaranteed loan of $200 million under the Defense Production Act of 1950. We were given every reason to believe that such a loan could be arranged and it was only at the last moment, namely on June 19, 1970, that Penn Central was advised that this would not be done. Inasmuch as I retired on June 8, 1970, I am not in a position to discuss anything that occurred after that time.

The facts which I stated in the pages immediately preceding were set forth in my testimony before the Subcommittees of the Senate Commerce Committee and the House Committee on Interstate and Foreign Commerce in July 1970.

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BOARD OF DIRECTORS' COMMITTEE ON INFORMATION DISCLOSURE AND CONFLICT OF INTEREST

I would like to comment briefly on the Committee on Information Disclosure and Conflict of Interest which was created by PC's Board of Directors, on my recommendation, at its meeting on September 24, 1968, It was an able and active Committee. Its functions were defined by the Committee in its report to the Board on December 19, 1969 as follows:

"Upon instructions from the Committee, counsel made a survey of the overall operations of the Company with particular emphasis upon areas involving (i) possible conflicts of interest; (ii) procedures for the dissemination of news to the general public; (iii) transactions in securities of the Company by directors, officers, and others, and (iv) the organizational structure of the Company. In the course of the survey counsel reviewed. among other materials, the following: annual reports and proxy statements for the past several years; periodic reports required to be filed by the Company with Securities and Exchange Commission ("SEC") ; periodic reports required to be filed by officers and directors with the SEC relating to their transactions in the Company's securities; reports required to be filed by PC and its directors and officers with the Interstate Commerce Commission ("ICC") ; copies of the questionnaire which the Pennsylvania Railroad Company sent in 1961 to its officers and directors relating to the subject of possible conflicts of interest and the answers thereto."

This Committee employed outside counsel—the firm of Skadden, Arps, Slate, Meagher, and Flom of New York—and made a number of studies on such matters as EJA, Penphil and "insider trading". It also prepared a Manual on Conflict of Interest and a Questionnaire on that subject—both of which were sent to directors and officers of PC and its principal subsidiaries. The Committee made frequent reports to PC's Board on its activities. Such matters as alleged conflicts of interest and monitoring of any trading on the part of directors and officers should be handled on the Board level rather than by me as Chief Executive Officer. Certainly, the problem of handling any such alleged transactions by me would have been inappropriate (such as inquiring into the personal affairs of officers and directors). It was for this reason that I asked the Board to create the Committee on Information Disclosure and Conflict of Interest. In the areas mentioned the Committee acted independently of management and had jurisdiction over these matters.

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THE WABASH TRANSACTION

On page 121 of the Bureau's brief, reference is made to acceleration of the exchange of Wabash stock for N & W stock. It is stated that: "Before N & W would advance the exchange date from October 15, 1970 to March 31, it exacted certain concessions from PC, including an agreement to sell certain land in Michigan at $20,000 per acre even though it had been assigned a market value of $30,000 per acre by an independent appraiser retained by PC (V.S. 9—pp. 12–14)".

This statement places an unfair light upon the transaction. In the first place, the Commission provided that the exchange of stock should take place "on or before October 15, 1970" and not on October 15, 1970. We had a legal right to execute the exchange prior to October 15, 1970—subject to ICC approval and it was approved by the Commission on March 26, 1970 (Finance Docket No. 21510).

Secondly, the transaction was advantageous to PC. The 675,000 shares of N & W stock to be received in exchange for 598,186 shares of Wabash were much more marketable than Wabash stock. Actually, there was no market for Wabash stock. Moreover, N & W stock would enable us to switch collateral and give Pennsylvania Company greater flexibility in its financing.

Another consideration from PC's standpoint of accelerating the exchange date was that the parties were able to settle a longstanding controversy between PC, N & W, and the City of Erie, Pennsylvania with reference to trackage in the streets of that city.

A further consideration was the sale of 28.62 acres of land in Melvindale, Michigan to the N & W. PC had had extended negotiations with N & W with reference to the sale of this property. PC's "trading" figure was initially $30,000 per acre—PC actually expected to get about $15,000 per acre. The land was acquired for $63,473 and was sold to the N & W for $572,400 cash. And, of course, cash was an important consideration. The sale was much more attractive because the N & W had had a lease on the property for ten years which expired on July 31, 1970. The rental on the property was only $8,080 per year—which, I doubt, would even pay the taxes.

But, the *important fact* is that the N & W had an option to renew this lease for another five (5) years from July 31, 1970 at this absurdly low rental. This is completely ignored by the Bureau's brief. The brief also ignores the fact (all of which is disclosed in V. S. 9, pp. 12–14, of ICC papers) that the appraised market value to which the Bureau's brief refers was on the basis "of this land, as if vacant." The property was not "vacant" for the N & W had been leasing the property for the purpose of loading automobiles in its cars for a period of 10 years and had a right, as stated above, to renew this lease for a period of 5 years from July 31, 1970 at the low rental just mentioned.

Moreover, the Bureau's brief ignores the fact (which the ICC records also disclose) that N & W has an option from Marathon Oil Company to purchase an adjoining 10 acre parcel until 1975, at $10,000 an acre, or half of what N & W paid per acre to PC. It was also provided that a new operating agreement would be entered into between PC and N & W whereby PC would be able to continue to use the premises for the purpose of loading automobiles in its cars. PC's use of the property amounted to about 20% and N & W's about 80%.

When all the facts are considered, PC's exchange of PC's Wabash stock for N & W stock was very attractive.

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ALLEGED DELAY OF THE RETIREMENT OF NON-DEPRECIABLE PROPERTY

At page 122 of the Bureau's brief it is stated that "PC's decision in September, 1969, to delay the retirement of non-depreciable property was motivated by the fact that such retirement would involve the recording of service losses". This charge is unfounded, and the next sentence of the Bureau's brief shows the real reason for what PC proposed to do. In September 1969, PC was in the process of preparing a "master abandonment program" whereby it hoped to get ICC approval for abandonment of some 5,800 to 6,500 miles of track. It was hoped that, by presenting a comprehensive or package program to the ICC, we could get much quicker relief than if PC proceeded on a piecemeal basis. It is a well-known fact that any proposed abandonment of consequence is subject to protracted hearings before the ICC and frequently Court proceedings to review the Commission's decision. This program was no secret—it was discussed with the Commission and the Commission has since made suggestions for expediting its trackage abandonment procedures.

The Trustees of PC actually propose to go much further with this program. Their proposal is to abandon some 9,000 miles of PC's trackage or almost one-half of its total mileage. They are now actively pursuing this approach.

* * * * * * *

Again, on page 122 of the Bureau's brief, criticism is made of PC's write-down of long-haul passenger equipment and facilities west of Harrisburg, Pennsylvania and Albany, New York, effective January 1, 1969. The brief shows that this matter was fully discussed with the Commission and that PC followed the advice of its independent auditors (PMM) in reporting this transaction to stockholders and at the same time footnoted the Commission's view in its Annual Report to Stockholders. It is significant that practically all other railroads having similar problems are following substantially the same approach in connection with their Amtrak transactions.

* * * * * * *

LABOR PROTECTION COSTS

The Bureau's brief discusses "Labor Protection Costs" (pages 89–98). It says that the agreement made on May 20, 1964, by Pennsylvania Railroad and NYC with 23 labor unions, representing some 77,000 employees has come to be known as the "Saunders Agreement". This characterization is unjustified. An agreement cannot be made by one party. All of the negotiations were at arm's length and every meeting with reference to the negotiations were handled jointly by Mr. Perlman and me, along with our respective vice presidents in charge of labor matters. Before the agreement was signed it was approved by the Boards of Directors of NYC and Pennsylvania Railroad, some three and one-half years before the merger.

The Bureau's chief focuses primarily on the merged company's obligation to "recalled" employees and indicates that the Pennsylvania and NYC should have offered evidence at the 1964 hearing regarding the costs of "recall" employees.

I did not prepare the figures with reference to the costs of the 1964 Labor Protection Agreement. They were prepared by the Labor Departments of the NYC and the Pennsylvania Railroad. I am advised by the Labor Department of PC that the reason no costs for "recalled" employees were included was the fact that no "present employees" were in a furloughed status on either Railroad at that time (September 16, 1964) and that no "recall" costs could be reported.

No one contemplated at that time that it would be some three and one-half years before the merger would be consummated. By December 1967, when we realized that this "recall" provision could prove quite expensive, we brought it to the Commission's attention and asked for special relief. All the facts were made known to the Commission. It had full opportunity to review the changed conditions and all the facts were presented to the Bureau of Accounts, and upon appeal, to Division 2 of the ICC. Division 2 approved the establishment of a Merger Reserve of approximately $275,000,000, including $117,000,000 primarily for "recalled" employees under the Labor Merger Agreement.

The Bureau's brief states that "since the agreement was 'unique', it is not surprising that counsel for other parties (including the Bureau of Enforcement) who questioned Mr. Saunders failed to inquire about applicants 'recall' obligation." (p. 91 of Bureau's brief). Not only was counsel for the Bureau present, but scores of other lawyers were present, including lawyers from the Department of Justice, many of whom were experienced in ICC proceedings.

They knew, or should have known, that the N. & W.–NKP–WAP Merger Labor Agreement of April 16, 1962 was the same, so far as "recalled" employee obligations, as the PC agreement.

Likewise, the N. & W.–Virginia Merger Labor Agreement of June 18, 1959 was interpreted to treat "recalled" employees substantially the same as such employees were treated under the PC agreement.

Both of the above agreements were reviewed by the ICC and approved by it, and, of course, the 1964 PC Labor Agreement was presented at the September 16, 1964 hearing for all of the numerous counsel to scrutinize and for purposes of cross-examination.

Subsequent to this hearing, but prior to the ICC's approval of the establishment of PC's Merger Reserve for "recalled" employees and obsolescent property, the Commission approved similar labor protection agreements in the Seaboard Coast Line and the Burlington Northern merger cases.

Taking this record of protection for "recalled" employees, starting with the N. & W.–Virginian Merger Labor Protection Agreement on June 18, 1959, it seems strange for the Bureau to claim that the PC agreement was "unique" in this respect.

Moreover, there were numerous appeals to the Federal courts to review the record before the Commission, particularly several appeals to the U.S. Court of Appeals for the 2nd Circuit and the Supreme Court of the United States. These appeals were vigorously contested and there was adequate opportunity to review every aspect of the merger. It was not until January 15, 1968, that the U.S. Supreme Court finally decided the case. In it's decision the Supreme Court said:

"Examination of the record and the findings in the present case satisfies us that the Commission has properly and lawfully discharged its duties with respect to the merits of the merger. In these elaborate and lengthy proceedings the Commission has considered evidence tendered by others and compiled by its own staff. Upon the aggressive suit of parties representing conflicting interests it has analyzed every pertinent aspect of the merger. . . .

"It has weighed conflicting viewpoints on all of the fundamental issues and many that are tangential. As the Commission concluded, the evidence before it, with negligible exceptions, attested to the probability of significant benefit from the merger, not only to the railroads and their investors, but also to shippers and the general public." (389 U.S. 486, 493).

DIVIDENDS

Neither PC, the Pennsylvania Railroad, nor to my knowledge, NYC had any fixed policy with respect to the payment of dividends. At each meeting where dividends were declared, the Finance Committee reviewed (a) financial results as of that time, (b) business outlook and (c) the cash situation and other relevant matters.

The Finance Committee would make dividend recommendations to the Board. The Board, itself, declared the dividends and, in every case, the action of the Finance Committee and of the Board was unanimous.

The last dividend declared by PC was at its June 1969 meeting. At the time the dividend was declared, the figures available showed that, on a consolidated basis, the dividend would be earned for the third quarter and for the year 1969.

POSITIVE STEPS TAKEN TO IMPLEMENT THE MERGER

It is significant that practically all of the ICC staff investigating PC only discuss negative aspects of PC and its predecessors. No mention is made of the fact that some $1.5 billion was spent on the railroad from 1963 through 1967; that the railroad spent some $70 million in developing the Metroliner service, which is proving to be a great success; that after the merger PC spent about $121 million in developing new yards and facilities, to wit: 10 classification yards were built or expanded and 35 key terminals and 24 freight stations were consolidated; that road operations had been combined at 29 points; that the ratio of cars awaiting repair was reduced from 9.2 to 5.9 percent; that the bulk of the capital expenditures to implement the merger were made prior to June 1970; that PC spent in 1968 and 1969 over $30 million on the Waynesburg branch which opened up a billion or more tons of coal traffic; that it built a new coal pier at Ashtabula, Ohio at a cost of over $13 million; that it built a new passenger station in New York at a cost of more than $30 million; that between February 1, 1968 (date of merger) and June 8, 1970, the employment of PC was reduced by 8,400 employees which meant a saving of more than $90 million each year; and that testimony before the ICC showed that it would take about eight years from the date of merger to attain the full merger savings and make it fully effective. Nor do the ICC investigators mention any of the factors discussed above as to the basic causes of the PC bankruptcy which amounted to many hundreds of millions of dollars.

* * * * * * *

At my meeting with Mr. Deller and Mr. Russo we also discussed Appendix "A" 1 of the Verified Statement of Peter N. Stravu in which he listed under the heading "Shares Recently Sold" of PC—1,517 shares sold by me. This statement was made sometime in 1970 or 1971 and is untrue. I have not sold any PC stock since March 1967. At that time, I sold approximately 4,000 shares, primarily to pay off bank loans. In December 1967, I bought over 40,000 shares of PC stock. I still have about 42,000 shares. In 1968 and 1969, I gave approximately 1,500 shares to charitable organizations and that is apparently what Mr. Stravu is referring to. These gifts were reported to the SEC. On the PC stock which I still hold, I have lost several million dollars of potential profits as well as the fact that I still owe substantially over one million dollars which I borrowed to buy this stock.

ADDITIONAL INFORMATION AVAILABLE TO ICC, OTHER GOVERNMENTAL AGENCIES, AND THE PUBLIC REGARDING THE FINANCIAL CONDITION OF PC AND ITS PREDECESSOR COMPANIES

I have made reference above to statements which I made between 1965 and 1970, particularly before the Senate and House Committees in the fall of 1969, with respect to the critical financial condition of the railroad operations of PC and its predecessors. At this point, I would like to call attention to other documents and opportunities which the ICC, other government agencies and the public had to familiarize themselves with these problems.

During the period 1965 to June 1970, there were literally hundreds of contacts between PC and is predecessors with the ICC and its various departments. I attach as Exhibit "A" a list of some of the reported and unreported proceedings before the ICC during the 1965–1970 period. It does not include all such proceedings, but is indicative of the matters that were presented to the Commission.

All of these were public proceedings in which the ICC and its staff had a full opportunity to inquire into the financial condition, including working capital, of PC. I refer particularly to the many PC merger proceedings before the Commission in this period, as well as those between 1967 and 1969 relating to the New Haven inclusion. In all of the proceedings, the financial condition and working capital of PC were the subject of review and public scrutiny.

I have already discussed the widespread and protracted opposition to the PC merger.

In many other proceedings before the ICC, there was adequate opportunity for the Commission to review PC's and its predecessors' financial condition. In the proceedings, for example, involving "Increased Freight Rates" in 1967, 1968 and 1969 (*Ex Parte* 256, 259 and 262), there appeared some 400 to 500 or more protestants in each proceeding and lawyers *ad infinitum*. These cases involved the financial condition of the railroads and in particular the PC and its predecessors.

In this connection, I refer to my Verified Statement in *Ex Parte* No. 259 where I said:

"The large reductions in working capital experienced by PC in the last eight years should also be brought to the Commission's attention. These are set forth in Appendix 9. The largest year-to-year decline was that shown for 1967 as compared with 1966. The 1967 figure showed a net working capital deficit of $119,720,864 (including debt due within one year among current liabilities). Our working capital position must be substantially improved. We cannot continue with this huge deficit, nor with the trend that is shown on Appendix 9."

I also attach as Exhibit "B" from the Verified Statment (Appendix 9) showing the working capital of PC and its predecessors from 1960 through 1967. An examination of this statement (which was a public document) shows that these railroads were in a dangerously bad condition.

The petitions of PC and its predecessors to issue commercial paper, to issue equipment trust certificates, to obtain bank loans, including standby and revolving credit loans for

several years prior to 1970, all required careful scrutiny by the ICC of every aspect of the PC's and its predecessors' financial position. These transactions ran into many hundreds of millions of dollars.

It is worth noting the problems that the Trustees of PC are having with their accounting and this is not said critically. For the year 1970 the Trustees had a variance of approximately $109 million in their estimate of earnings in a period of about 30 days.

The Trustees proposed earnings for 1971 is even more striking (and, mind you, PC stock is still being traded on the principal stock exchanges). According to a petition filed by the Trustees with the Federal Reorganization Court on March 27, 1972, they asked the Court to overrule the ICC Bureau of Accounts and Division 2 and permit them to show a loss of $284,520,000 instead of $560,152,00 0under ICC-accounting practices. Ironically, the Trustees wait (1) to claim a credit of $137,213,000 for the unused balance remaining in the Merger Reserve Account for labor protection costs and (2) to claim a credit for $136,419,000 for obsolescence in connection with Amtrak.

These figures indicate some of the problems involved in running a railroad like PC.

As a matter of fact, the Commission stated in its Report of March 17, 1971 to the Honorable Warren G. Magnuson, Chairman of Senate Committee on Commerce and to the Honorable Harley O. Staggers, Chairman of House Committee on Interstate and Foreign Commerce that:

"The present condition of the railroad industry, including the distress of the Penn Central Company, is not attributable to the Nation's transportation merger policy of the administration of the merger laws. When the ICC was appraising the Penn Central merger proposal, it noted that in none of the preceding five years did the New York Central have sufficient net railway operating income to meet fixed charges. Except for one year (1964) the same was true for the Pennsylvania Railroad. Neither railroad had made a profit in the transportation business for many years, and this was especially significant since the national economy was approaching record levels for sustained expansion. Their working capital was dangerously low."

Beyond everything that is mentioned above as to the Commission's and to the public's knowledge of PC's financial condition is the fact that PC officers and its predecessors, as well as PMM, had many discussions with the Cimmission (verbally and written), in non-advisory proceedings, regarding accounting treatment of various transactions. The ICC Bureau of Accounts has maintained an Office and staff in Philadelphia from at least 1965, a primary function of which has been to police and review the accounting and financial practices of PC and its predecessor, the Pennsylvania Railroad.

The financial results, accounting practices and merger proceedings of PC and its predecessors were subjected probably to the most widespread newspaper, radio, television and magazine coverage ever given to any company for a period of many years prior to June 1970.

At a hearing before the Special Subcommittee on Investigation of the House Committee on Interstate and Foreign Commerce (September 24, 1970) at which, among others, were Mr. Dale W. Hardin, then Vice Chairman of ICC, Mr. Richard B. Smith, a Commissioner of SEC, Mr. Fritz R. Kahn, General Counsel of ICC, Mr. Philip A. Loomis, Jr., General Counsel of SEC, Mr. Irving H. Pollack, Director, Division of Trading & Markets, SEC, and Mr. Matthew Paolo, Director of Bureau of Accounts, ICC. Mr. Pollack testified as follows:

Mr. LISHMAN. (Chief Counsel of House Subcommittee). "Did the SEC consider a suspension of trading [in PC stock]?"

Mr. POLLACK (Director of SEC Division of Trading and Marketing). "No."

Mr. LISHMAN. "Why not?"

Mr. POLLACK. "Because I think at that point the information concerning the filing of the petition in bankruptcy was publicly known. There had been during the early part of 1969 and continuing to the filing of the petition a release of information idicating a deterioration in the financial condition of Penn Central."

* * * * * * *

This statement cannot be considered as an answer to all the points raised by the ICC or other governmental investigations. It is simply an attempt to comment on some areas which were covered by the ICC investigation. If you desire any additional information, I will be glad to furnish it.

I hope that you will submit this statement to the Commission and that the Commission will submit it to anyone else to whom its reports are sent.

Respectfully,

STUART T. SAUNDERS.

[EXHIBIT "A"]

SELECTED PCTC–ICC CASES

1. *Ingot Molds from Pa. to Ky.*, 323 ICC 758 (1965), 326 ICC 77 (1965).
2. *Investigation of Adequacy of Freight Car Ownership*, 322 ICC 48 (1964).
3. *Official-Southern Divisions*, 325 ICC 1 (1965).
4. *Merger NYC into PRR*, 327 ICC 475 (1966); 328 ICC 304 (1966); 330 ICC 328 (1967); 331 ICC 643 (1967); 331 ICC 754 (1968); 334 ICC 25 (1968); 334 ICC 528 (1969).
5. *Issuance of Notes by Pennsylvania Tunnel & Terminal R.R. guaranteed by PRR*, 328 ICC 253 (1965).
6. *Discontinuance of trains between NY, NY, and St. Louis, Mo.*, 328 ICC 921 (1965); 330 ICC 458 (1966).
7. *Increased Freight Rates 1967* (Ex Parte 256), 329 ICC 854 (1967); 332 ICC 280 (1968).
8. *PRR Lease (Newark-Journal Square) to PATH*, 330 ICC 503 (1966).

9. *PRR Discontinuance of Trains between Chicago, Ill., and Valparaiso, Ind.*, 331 ICC 464 (1968).
10. *Canned Goods between Pacific Coast and the East*, 332 ICC 55 (1967).
11. *Increased Rates, 1968, Ex Parte 259*, 332 ICC 714 (1969).
12. *Discontinuance of Trains Detroit to Chicago*, 333 ICC 768 (1968).
13. *Discontinuance of Trains New York to St. Louis*, 333 ICC 736 (1968).
14. *Discontinuance of Trains Chicago to New York*, 333 ICC 638 (1968).
15. *Discontinuance of Trains Chicago to Cincinnati*, 333 ICC 674 (1968).
16. *Discontinuance of Trains Albany to Boston*, 334 ICC 618 (1969).
17. *Discontinuance of Trains Harrisburg to Buffalo*, 334 ICC 312 (1969).
18. *Discontinuance of Trains St. Louis to New York*, 334 ICC 638 (1969).
19. *Investigation of Adequacy of Freight Car Ownership, Ex Parte 241*, 335 ICC 264 (1969).
20. *Multiple Car Rates, Canned Foodstuffs*, 334 ICC 612 (1969).
21. *Penn Central Fare Revision*, 335 ICC 720 (Jan. 1970).
22. *Vegetables and Melons Transcontinental Eastbound*, 335 ICC 798 (Feb. 1970).
23. *Penn Central Transportation Co. Notes*, 336 ICC 1 (1969).
24. *Penn Central Notes* (F.D. 25931), 336 ICC 280 (1969).
25. *Penn Central and I.C. Train Discontinuance*, 336 ICC 56 (1969).
26. *Penn Central Train Discontinuance*, 336 ICC 182 (1969).
27. *Penn Central Train Discontinuance*, 336 ICC 416 (Feb. 1970).
28. *Penn Central Train Discontinuance*, 336 ICC 518 (March, 1970).
29. *Penn Central Train Discontinuance*, 336 ICC 759 (May, 1970).
30. *Increased Rates 1969*, Ex Parte 262, ——— ICC ——.
31. *Increased Rates 1970, Ex Parte 265* (Filed March 3, 1970).

Unreported I.C.C. Cases

1. *PRR Notes*, F.D. No. 24634, July 17, 1967.
2. *Penn Central Notes*, F.D. 25179, August 15. 1967.
3. *Penn Central Notes*, F.D. 25397, December 11, 1968.
4. *Penn Central Notes*, F.D. 25570, March 20, 1969.
5. *Penn Central Notes*, F.D. 25622, May 16, 1969.
6. *PRR Equipment Trust*, Series A, F.D. 24014, March 8, 1966.
7. *PRR Equipment Trust*, Series B, F.D. 24014, May 21, 1966.
8. Not completed.
9. *Penn Central Debentures*, F.D. 25114, 1968.
10. *Lease of N. Y. Connecting*, F.D. 25811 and F.D. 25833, 1969.
11. Not completed.
12. *Guaranty of Bonds, Waynesburg Southern*, F.D. 25089, 1965.
13. *Lease of Little Miami*, F.D. 25362, 1969.
14. *PC Holding Co. Control of Penn Central*, F.D. 25660, August 7, 1969.
15. Sale of Long Island R.R., F.D. 23956, 1966.

ADDITIONAL UNREPORTED ABANDONMENT AND TRAIN DISCONTINUANCE CASES, 1965 TO 1970

Applicants	Finance docket No.	Application for—
P. R. R. Co	23554	Abandonment.
P. R. R. Co	23614	Do.
P. R. R. Co	23735	Do.
P. R. R. Co	23736	Do.
P. R. R. Co. and Penndel Co	23763	Do.
P. R. R. Co. and P. B. & W	23922	Do.
P. R. R. Co	24278	Do.
P. R. R. Co	24279	Do.
P. R. R. Co. and Penndel Co	24282	Do.
P. R. R. Co. and P. B. & W	24401	Do.
P. R. R. Co. and Penndel Co	24602	Do.
P. R. R. Co	24612	Do.
P. R. R. Co	24793	Do.
P. R. R. Co. and P. B. & W	24831	Do.
P. R. R. Co. and P. F. W. R. R. Co., and Cleveland and Pittsburgh	24963	Do.
P. C. T. Co	25088	Do.
P. C. T. Co. and Lake Erie and Pittsburgh	25094	Do.
Penn Central Co. and Penndel Co	25160	Do.
Penn Central Co. and P. B. & W	25335	Abandonment.
P. C. T. Co. (trains 574–575)	25373	Discontinuance.
P. C. T. Co. (trains 24–33)	25558	Do.
P. C. T. Co. (trains 50–53)	25755	Do.
P. C. T. Co. and Connecting Railway	25817	Abandonment.
P. C. T. Co. (trains 574–575)	25859	Discontinuance.
P. C. T. Co. (trains 574–575)	25895	Do.
P. C. T. Co. (trains 354)	25898	Do.
P. C. T. Co	25899	Abandonment.
P. C. T. Co	25913	Do.
P. C. T. Co	25925	Do.
P. C. T. Co	25936	Do.
P. C. T. Co. and Connecting Railway	25971	Do.
P. C. T. Co. and Little Miami Railway	25973	Do.
P. C. T. Co. (trains 65–66)	26011	Discontinuance.
P. C. T. Co	26018	Abandonment.
P. C. T. Co	26023	Do.
P. C. T. Co. and Michigan Central	26036	Do.
P. C. T. Co. (trains 15–18)	26065	Discontinuance.
P. C. T. Co. and Penndel Co	26147	Abandonment.
P. C. T. Co. (trains 136–7, 142–7)	26165	Discontinuance.
P. C. T. Co. (trains 572, 578, et al.)	26182	Do.
P. C. T. Co	26194	Abandonment.

[EXHIBIT "B"]

PENN CENTRAL WORKING CAPITAL FOR THE YEARS 1960 THROUGH 1967

Year	Working capital [1]	Materials and supplies	Working capital [2]	1 year debt	Working capital [3]
1960	$78,798,139	$80,886,817	($2,088,678)	$64,170,989	($66,259,667)
1961	53,181,021	74,962,052	(21,781,031)	64,428,731	(86,209,762)
1962	45,026,553	70,900,942	(25,874,389)	73,763,441	(99,637,830)
1963	28,039,393	69,892,872	(41,853,479)	60,866,779	(102,720,258)
1964	41,071,657	67,242,047	(26,170,390)	58,705,267	(84,875,657)
1965	72,287,619	79,927,598	(7,639,979)	72,877,958	(80,517,937)
1966	77,704,771	90,662,241	(12,957,470)	76,764,553	(89,772,023)
1967	34,895,458	85,681,305	(50,785,847)	68,935,017	(119,720,864)

[1] Current assets less current liabilities.
[2] Working capital less materials and supplies.
[3] Working capital less materials and supplies and 1-year debt.

Note: The figures above are the sum of the separately reported positions of The Pennsylvania Railroad Co., and New York Central. Figures in parenthesis denotes deficit.

EXHIBIT 70

PHILADELPHIA, *May 21, 1963.*

A meeting of the Finance Committee of the Board of Directors of The Pennsylvania Railroad Company was held this day at 7:15 P.M.

There were present Messrs. Symes, Chairman, Gowen, Clarke, Hollister, Ingersoll, Day and Bevan.

There were also present by invitation Messrs. R. G. Rincliffe, Howard Butcher, III, A. J. Greenough, President, and John B. Prizer, Vice President and General Counsel.

The Chairman reminded the Committee that the Examiner in the case before the Inter-State Commerce Commission involving the merger of the Norfolk and Western Railway Company and New York, Chicago and St. Louis Railroad Company recommended that as a condition to the merger, The Pennsylvania Railroad Company be required to divest itself of its ownership of stock in the Norfolk and Western. This Company and Pennsylvania Company together own 2,397,284 shares of Norfolk and Western common stock having a total current market value of $288,872,723. Of these shares, 1,711,343 are pledged as collateral for loans but the remaining 680,000 shares are available for sale. He stated that there are two questions to be decided in the near future—whether to begin selling Norfolk and Western stock, and if so, how to invest the proceeds. He thereupon asked Mr. Bevan to discuss the problems involved in deciding these questions.

Mr. Bevan reported that for some years Pennsylvania Company has played an important part in the financial program of The Pennsylvania Railroad Company. Fortunately it has been possible to adhere substantially to the program approved by the Board in 1953. Recently the consolidated mortgage bonds in the principal amount of $35,000,000, were refinanced and $49,000,000 of Chicago Union Station bonds have just been refinanced at an interest cost to us of 4.64%. However, the next seven years will be the most difficult from a financial standpoint of any period in the history of the Company. Earnings during the past five years amounted to only $695,000 and there is no assurance of a sudden upturn in net profits. For the years 1952 to 1962, inclusive, there was a cash loss of about $110,000,000 notwithstanding the receipt of approximately $10,000,000 a year from the sale of real estate. During 1963, based on current budget estimates, there will be a net cash loss of $20,000,000. At the end of 1962 there was an adjusted working capital deficit of $60,000,000 and at present this deficit is $68,000,000. Provisions will have to be made for maturities during the next seven years of $565,000,000, including $61,000,000 of 4½% General Mortgage Bonds of 1965, $20,000,000 of Pittsburgh, Cincinnati, Chicago and St. Louis 5% Bonds of 1970, and $46,000,000 of General Mortgage 5% Bonds of 1968. In addition, the merger with the New York Central Railroad Company will require capital expenditures during the first five years of $75,000,000, less $45,000,000 to be provided through salvage. The New York Central at the end of 1962 had an adjusted working capital deficit of $40,000,000. Both companies had a net income deficit last year and if there should be a deficit for them again this year, there will be a further cash loss.

He stressed the importance under these conditions of maintaining liquidity and credit. Liquidity is presently provided by Norfolk and Western common stock and this fact is recognized by the financial institutions. Credit is available in Pennsylvania Company and it is essential to continue this situation for purposes of further borrowing. A third important ingredient in the financial picture is the necessity of replacing the income which is currently being received on the Norfolk and Western stock. He plointed out that largely through the use of this income Pennsylvania Company has been able to bolster the financial needs of The Pennsylvania Railroad Company. Its net income has increased from $11,000,000, in 1946 to $24,000,000, as of last year. In the meantime, Pennsylvania Company has made cash available to this Company and has acquired interests in other railroads such as the Detroit, Toledo and Ironton and Toledo, Peoria and Western Railroad Companies. Total earnings for the ten-year period beginning in 1953 have amounted to $209,000,000, of which $198,000,000, has been made available to this Company either in the form of dividends or by purchase of securities. These earnings must be maintained.

If proceeds from the sale of Norfolk and Western stock were to be used to retire debt at, for example, 6%, this would be the same as investing money on a 2.88% basis taking income taxes into consideration. At the same time, the dividend income which is now subject only to a 7.8% tax would not be forthcoming. On the other hand, Norfolk and Western common stock at $120 per share provides a 4.58% return before taxes and 4.22% return after taxes. If all unpledged Norfolk and Western common stock were to be sold and the proceeds invested in 4½% bonds, the income would be only $6,000,000, after taxes compared with a present return of $12,156,000.

During the years 1954 to 1962, inclusive, consolidated net profit amounted to $214,000,000, but $13,000,000, was taxable before the dividend allowances. There is presently an $85,000,000, carry-forward tax loss which will be reduced by $7,000,000, for the year 1962 because of gains on certain sales.

If cash received from Norfolk and Western stock should be used to retire debt or should be reinvested in the property, the result would be to concentrate rather than diversify.

The Vice President, Finance, recommended as a general program that the Company gradually sell its Norfolk and Western stock until the ownership is reduced to about 15% and that the proceeds be invested in common stocks equal in quality to Norfolk and Western. Preferably, 80% of the stock of a given company should be acquired in order to permit the filing of consolidated income tax returns and take advantage of our tax losses. In looking for a company in which to invest, his Department has seriously considered a pipeline company in the general area served by the railroad, and the Buckeye Pipeline Company appears to offer the best possibilities. He thereupon reviewed pertinent information concerning that company, which had been sent to the members of the Committee before the meeting.

During the discussion period which followed, it was suggested by one member that the Company dispose of his holdings in Norfolk and Western to the extent possible and devote the proceeds to the purchase of its own bonds in preparation for the maturities of 1965 and 1968. This course of action, he said, would not only solve many of the financial problems but remove the obstacle to the Norfolk and Western merger case which ownership of Norfolk and Western stock by this Company presents. He also expressed the opinion that the market value of the Norfolk and Western common stock is now very high and may not continue at that level indefinitely.

Other problems discussed were the means of compensating for the capital gain resulting from the sale of Norfolk and Western stock, the desirability of obtaining cash through the sale of such stock rather than creating additional debt, the future of Norfolk and Western Railway Company and the general requirements for cash facing this Company within the next seven years.

It was the sense of the meeting that the financial officers should study the situation further and come back with recommendations at the next meeting probably to be held in about a month.

On motion, adjourned.

BAYARD H. ROBERTS.

EXHIBIT 71

AUGUST 31, 1966.

S. T. S.: In considering the capital budget for 1967, I think it is desirable that we consider a number of salient factors in arriving at a conclusion as to the level of expenditures which are necessary and expedient and also prudent in light of all the circumstances.

During the ten-year period 1956–1965, inclusive, New York Central including the P&LE spent $452 million on equipment and the Pennsylvania Railroad spent $875 million, or almost twice as much.

During the years 1964 through 1966, it is estimated that we will spend $480 million. To meet these commitments we have had to increase our debt sharply and reduce our cash resources to minimal margins. In the two years 1965–66, exclusive of intercompany transfers of debt, our interest charges on an annual basis will have increased by $13 million and our annual depreciation by $4.5 million or a total of $17.5 million, equal to $1.26 per share.

In 1967 it is estimated that our maturities will be somewhere in the neighborhood, depending on the level of our capital program, of about $56 million. This compares with estimated equipment depreciation of $37 million. Our road depreciation is estimated at about $19 million so that it will take our entire depreciation now to meet our 1967 maturities. The usual rule of thumb formula used by analysts of the railroad industry is that when equipment depreciation equals equipment maturities, you are fairly well in balance but anything above this is a danger signal and I might add that analysts are already commenting on this deficiency in our case.

As contrasted to our situation, the New York Central depreciation for 1966 is estimated at about $42 million and their maturities at $20 million.

The attached exhibit clearly indicates that we are not realizing anything but a nominal return on the huge capital investment we have put into the Pennsylvania Railroad in the last three years.

For 1967, as you know, the Operating Department has submitted a proposed budget of $57 million for road and $175 million for equipment or a total of $232 million. It is my understanding that you have tentatively asked them to reduce the equipment budget to $140 million.

First, the requested road budget of $57 million is, I believe, the highest in the history of the Pennsylvania Railroad. In 1965 it was $49,800,000 and in 1966 it was set at $53.7 million with the request that further reductions be made in it. The extent of these reductions are as yet unknown from our standpoint.

The requested increase in the total budget of 1967 is despite the fact that the 1966 budget contains $2.5 million for merger items not in the 1967 budget and the Pennsylvania Station, New York, expenditures will be $4.5 million less than in 1966. The equipment budget even at $140 million has only been exceeded twice in the past when it was $147 million in 1960 and $194 million in 1965. It will represent an increase of about $5 million over 1966.

Looking at this budget from a cash standpoint, if we accept the premise that we cannot go back to New York Central for a change in the debt limitation, about the maximum we can finance as indicated in a previous memorandum is $85 million. On this basis of $140 million there is a cash requirement for equipment of about $55 million. If you add to this the request of $57 million for road this represents a total of $112 million. To this is added the regular dividend in 1967 of $2.40 per share or approximately $34 million, a grand total of $146 million.

As now estimated, our cash on hand at the end of the year will barely support the outstanding loans we have with banks and, therefore, no further draw down of our cash resources will be practical in 1967. At the present time it appears that the Pennsylvania Railroad, including dividends to be received from the Pennsylvania Company, will only realize about $40 million net income in 1966. With a real possibility of a slow down in business next year as a result of our tight money situation coupled with increased costs in the form of wage increases, it does not seem reasonable at least to budget on a basis of any higher net than will be realized this year. Therefore, if you subtract a total of $40 million and I might add all this will not be true cash flow, there still is a minus cash flow of approximately $106 million with no indicated way of meeting it.

Turning to another area, at the present time we are confronted with the tightest money situation in my business career and most of the knowledgeable financial people that I know consider it far more serious than the general public seems to realize. The top New York banks are now approaching the unheard ratio of 85% of loans to deposits and they have yet to encounter their full peak. Most of the big insurance companies are now making commitments for the latter part of 1967 and 1968. Unless something gives some place, there are going to be many high grade companies, not to speak of the weak ones, who just will not be able to get funds next year. It should also be kept in mind that there are a number of high credit companies that carried large balances without borrowings for many years. These are now coming into the banks and they must be taken care of regardless of anything else and it is quite likely that other top companies which have been consistent borrowers, such as the Pennsylvania Railroad, may be told that we have more than our share and that no more is available to us. General Electric Company, as an example, is coming into Philadelphia banks for probably the first time in history for any sizeable amount and I could cite a number of other companies on the same basis. Therefore, no one at this point can give any guarantee of just how much money can be raised next year regardless of the debt limitation factor.

If something does give, and if the administration continues its policy of monetary restraint, the only place it can give is an easing of business and, therefore, the loan demand. If this occurs, of course, our business will not be as good as this year. It is also a fact that almost certainly there will be a GE strike this Fall and I think it is quite likely at the present time that we in the railroad industry may likewise be faced with a strike next year. After the plane strike and settlement, the feature of retroactivity, which has a direct bearing on our cash resources, looms quite large.

All in all it seems to us that a very cautious and conservative policy should be followed until the economic outlook is clarified and that our capital expenditures should be held to a bare minimum. I am quite sure that as time progresses it will be found that we will have lots of company in this direction because most of the factors with which we are confronted are faced by most of the railroad industry as well as other companies. On top of these, of course, we are handicapped by a debt limitation problem and the fact that our cash resources are down to minimum levels and our debt has substantially increased in the last three years.

D. C. B.

EXHIBIT 72

OCTOBER 5, 1967.

PERSONAL AND CONFIDENTIAL

D. C. BEVAN: I recommend that the salary of Charles S. Hill, Manager, General Accounting, be increased effective November 1, 1967 from $25,500 to $27,500 annually.

Hill has done an outstanding job in the General Accounting capacity and his background, personality and interest are ideal for this important position. Prior to joining the Pennsylvania Railroad in 1955 he was a Regional Comptroller in the Post Office Department and is a Certified Public Accountant in the State of Virginia. He has been instrumental in the progress that has been made in the Accounting Department within the last several years. He is extremely creative, is an excellent manager and is very cost conscious. His imaginative accounting is adding millions of dollars annually to our reported net income. Although he has consistently assumed additional work within his organization, he has

reduced the number of employes from 268 to 167 since being appointed to this position in 1963, a reduction of 101 or 38%. He has constantly underrun his budget which has been reduced each year since he has been responsible for this function.

Mr. Hill is an unusually qualified accountant and is highly regarded in the railroad industry, by the public accounting fraternity and by his associates within the Company. He is very familiar with I.C.C. accounting and at the same time is a real authority on generally accepted accounting principles. I cannot overstate the contribution that he has made to the Company within the last several years.

The range on Hill's job is $22,620 to $29,580 a year. Mr. Hill's last increase was granted in April 1966.

May I please have your approval of this recommendation subject, of course, to subsequent approval of Mr. Saunders.

W. S. Cook.

Exhibit 73

June 2, 1969.

D. C. Bevan: This refers to Mr. Gerstnecker's letter of May 29 to you, copy of which you handed me. I gather that the new settlement with Messrs. Wynne, Baker, Ray and Caldwell is the best that can be made under the circumstances and subject to the comments which I am making here it has my approval.

In talking with Mr. Gerstnecker this morning, I suggested that we attempt to work out some provision for an adjustment downward in the capital settlement if in any given year the earnings of Great Southwest do not reach $25 million in that year. He said he would see what could be done about this.

I understand Mr. Gerstnecker believes, and I gather you also agree, that the new settlement and agreement will provide sufficient incentives for these officers to maximize Great Southwest's earnings.

I also understand that there is a provision for termination of the services of any of these particular officers in case we are not satisfied with the results which they produce.

S. T. Saunders.

Exhibit 74

[Interstate Commerce Commission, Docket No. 35291, Verified Statement 11, Exhibit NPE 8, Memo in working papers of Peat, Marwick, Mitchell & Co.]

Penn Central Company—1969 Accounting Problems

1. merger reserves

The merger of the Pennsylvania and New York Central railroads occurred on February 1, 1968. As the transaction was considered to be a pooling of interests, the roads issued combined financial statements for the year 1967. Included as an extraordinary charge in the earnings statement for that year was a provision in the amount of $275,422,000 for "costs and losses incurred upon merger." While these statements were not audited by PMM & Co., consultations were held with Mr. Hanson, Messrs. Webster and Quinn, and the Department of Professional Practice on certain accounting matters including the establishment of the merger reserve. Mr. Hanson, in fact, visited the ICC on behalf of Penn Central and supported the company's position in setting up the reserve.

The original purpose of the reserve was to provide for duplication or obsolescence of certain railroad properties, equipment, materials and supplies and for the requirement to rehire certain otherwise surplus furloughed employees resulting from the merger of the New York Central Railroad Company into The Pennsylvania Railroad Company. Approximate amounts provided and the principles applied in compiling the respective segments of the reserve were as follows:

1. Facilities ($149,000,000)—Facilities which the company's engineers determined to be excess or unneeded have been included in the reserve at net book value less estimated salvage value, plus costs of demolition, etc. In applying this principle PC was guided by the concept of costs or market, whichever lower. Any property to be abandoned was left on the books at cost if it was determined that the property could be sold for cost or above cost; otherwise it was written down to the anticipated selling price. It should be noted that under this method if a substantial gain was anticipated on the sale of real estate no longer needed for railroad operations, this anticipated gain was not offset against the estimated losses.

2. Equipment ($3,000,000)—Losses (net book value of equipment less estimated salvage value) were determined primarily on the basis of whether equipment would be needed at a specific location. These losses apparently were considered by the chiefs of operations and maintenance on an overall basis, but not with a view toward recognizing losses only if equipment is to be scrapped.

3. Materials and Supplies ($6,000,000)—Losses (net book value less estimated salvage value) included both items to be scrapped and, to some extent, the value of excess stocks.

4. Labor ($117,000,000)—An estimate was prepared by location of all job requirements. This was compared to the total number of persons to be employed subsequent to merger. After consideration of those who would not return to work when recalled and

those who would be used to fill job requirements (as defined), a provision was made for (a) the cost of relocating recalled employees, (b) settlement with employees who would not accept transfer to a qualified job, and (c) wages to be paid to employees not filling qualified jobs.

The following summarizes the activity in the reserve account since inception:

[In thousands]

	Original provision at Dec. 31, 1967	Year 1968	9 months ended Sept. 30, 1969	Balance Sept. 30, 1969
Facilities	$149,347	10,959	2,037	136,351
Equipment	3,133	3,156	412	(435)
Materials and supplies	6,014	3,145	611	2,258
Recalled labor:				
Severence payments		7,618	4,478	
Other charges: Altoona works (principal location utilizing recalled labor)		3,238	3,535	
All other locations		11,604	4,591	
Total	116,928	22,460	12,604	81,864
Grand total	275,422	39,720	15,664	220,038

The problems encountered in determining the appropriateness of charges against the reserve are discussed below:

Facilities

In our initial discussions with PC we were told that duplicate facilities would be abandoned within approximately two years from date of merger. This timetable has proved to be too ambitious. The current level of activity would suggest that it may be many years before this portion of the reserve is used up, and this raises the question as to its necessity. We are, however, generally satisfied with the validity of charges to date.

Equipment

This portion of the reserve now has a negative balance. We are still discussing this situation with management to determine if future equipment charges will be forthcoming. Management believes that the negative balance should be offset against the remaining credit balance in the facilities protion of the reserve. If the charges are now substantially complete, we believe this would be acceptable.

Materials and Supplies

It was our understanding that obsolete and duplicate items would be scrapped within the first year of merger. It would seem that such materials would easily be identified and physically eliminated. We have expressed this concern to management. It is our intention to insist that management now identify all remaining items to be scrapped and establish a definite date for completion of the program.

Recalled Labor

This is the biggest problem area from an audit standpoint. The reserve was calculated on the assumption that 4,447 employees would return; whereas only 2,877 actually returned. During 1968 and the first nine months of 1969, a total of 1,478 recalled employees were severed and apparently 206 were absorbed into the labor pool, leaving 1,193 on the "recalled" list.

Under the original concept of recalled labor, specific persons would be identified as being recalled without a specific job assignment. They would then either be idle or placed on "make-work" projects, such as cleaning up facilities which otherwise would not have been cleaned, etc.—in all cases the work was to be demonstrably "non-productive." As time went by, the concept of "recalled labor" was extended to include "substitutes" within the same union. "Substitute" status is reached when a recalled employee is added to the active labor pool and an otherwise active employee with seniority elects to assume (or is transferred to) a non-active role. PMM&Co. agreed to the substitution arrangement, since it consisted in maintaining a one-for-one balance of active and non-active employees.

Recalled employees, in fact, do not stand around idle. All are given work assignments and are integrated into regular working teams, particularly at Altoona, which has the greatest number of recalled employees. The determination that a recalled employee is not productively employed is left to the discretion of operating management personnel. Different colored time cards are used to distinguish "chargeable" versus "non-chargeable" labor costs. Essentially, as far as we can determine the labor costs of all recalled employees not working on capital projects gets charged against the reserve.

In our audit work thus far, we have made visits to the shops and from visual observation we could not distinguish regular workers from recalled personnel—all seemed to be doing the same work. Management rebuts that the size of work crews has increased, but not their productivity and, therefore, they are still burdened with the costs of unneeded personnel. We have requested engineering studies or statistical proof that this is the case, but

have not received an answer to date. The question remains whether, in principle, we can accept such data as a basis for charges against the reserve.

We agreed at the outset that this portion of the reserve should not be used beyond about a five-year period. It should be noted, that on this basis over half the labor reserve will not be used.

EXHIBIT 75

PHILADELPHIA, *May 13th, 1969.*

A meeting of the Finance Committee of the Board of Directors of Penn Central Company was held this day at 12:00 Noon.

There were present Messrs. Bevan, Chairman, Granger, Hanley, Lunding, Perlman, Routh and Saunders.

The Chairman of the Board reviewed briefly estimated earnings on a consolidated basis for the second quarter of the year. He reported also on the steps being taken to improve the earnings of the railroad.

Whereupon the Committee, on motion, approved a recommendation to the Board that it declare a regular quarterly dividend of sixty cents a share.

On motion, adjourned.

EXHIBIT 76

BOARD MEMORANDUM, TUESDAY, MAY 13, 1969

Proposed Dividend

At this time we will take up the matter of the Second Quarter dividend.

Our earnings projections for the Second Quarter are inconclusive as of this time. We estimate, however, that our consolidated earnings will be around $20 million.[1] This compares with $18.7 million (an improvement of nearly 10%), for the Second Quarter of 1968, after taking into account the $4.9 million loss incurred by the New Haven in the same period.[2]

Our preliminary figures show that while it is still an uphill fight, we are making real progress in bringing the railroad back into the black. For the first three months of this year the railroad produced a $12.8 million deficit, but we expect to be well above the break-even point by the end of June. One adverse development arises out of the recent decision in the Southern Divisions Case. As it stands, the order of the Federal Court in New Orleans will require the repayment of about $11.4 million. Some undetermined portion of this will be a charge against income this quarter, but we will not know how much until the I.C.C. acts on our petition to price the offsetting items and balances are settled.

The strike that began at seven General Motors plants on April 28 is costing us about 225 cars per day, which is at the rate of about 5,000 cars per month. If it continues, the monthly revenue loss will be over $1 million.

On the other hand, steel production continues very strong and is running at a level only 2% below a year ago during the pre-strike inventory build-up.

Since the settlement of the wildcat strikes, coal output has been high and our coal carloadings have been showing better trends than production generally. For the first five weeks of the Second Quarter our coal carloadings are 3.5% ahead of last year.

Despite the effect of the General Motors strike, business is holding up very well and we are rapidly regaining the share of the market lost during the last six months because of our service difficulties. Based on traffic levels for the 2-year period prior to merger, Penn Central has traditionally handled about 35% of Eastern District ton-miles. During the last quarter of 1968 we dropped to about 30 percent, then rose to 33 percent last quarter. In April we experienced a further improvement—to 34.4 percent. This is equivalent to a gain of 297 million net ton miles, a 4% improvement over the monthly average of the first quarter. Based on this trend, we recently established our revenue goal at $402.7 million, which is $10.5 million above our original forecast, and $18 million above Second Quarter last year. Based on recent reports from the field, our Sales people say that our prospects are excellent for attaining this goal.

We are also paying a great deal of attention to cost control. Last week Mr. Perlman and I met with all of our General Managers, together with the Regional Accounting and Sales Officers, to revise the Second Quarter expense budgets in line with our income requirements. We had hoped to catch up on a great deal of maintenance work this spring, but it now appears that we will have to cut back on some of these plans. The expense goal is $356 million, which is $20 million below the original forecast and $13.5 million above the Second Quarter of last year. Status reports from the Regions are due today.

A recent check of the diversified subsidiaries indicated a $2.5 million increase over the original forecast for Buckeye, Great Southwest and Macco. In addition, Great Southwest

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[1] For basis of this estimate, see attached Summary dated May 5, 1969.

[2] Second Quarter 1968 Penn Central (excl. New Haven).

Railroad	$1.413
Subs	22.208
Consolidated	$23,621

is working on a large transaction which, if completed in the Second Quarter, could increase our net by $10 to $12 million. We will give you more details on this at an appropriate time.

While, as I have said, it is much too early to know exactly where we will come out, I think that prospects are very good to equal or better the results in the Second Quarter of last year.

Recommendation.—In light of the results to date and the prospects for the remaining weeks of this Quarter, the Finance Committee recommends the payment of the regular quarterly dividend of 60¢ per share, payable June 20th to stockholders of record at the close of business on May 26th.

Will someone make a motion approving this recommendation?

All in favor, please say "yea"

Opposed, "no"

So ordered.

SECOND QUARTER 1969—RAILROAD EXCLUDING PROPERTY SALES AND NEW HAVEN

[Dollars in thousands]

	2d quarter 1969 forecast, May 5, 1969	Goal	2d quarter 1969 budget	2d quarter 1968 [1]
Operating revenues:				
Freight	$333, 275		$343, 325	$324, 655
Passenger	27, 500		26, 500	25, 746
Mail	12, 275		11, 525	15, 143
Express	1, 550		2, 250	3, 075
All other	17, 775		19, 150	17, 358
Total Revenues	392, 375	$402, 750	402, 750	385, 977
Expenses:				
Operations departments:				
Administration	15, 301		16, 027	NA
Stations	20, 889		21, 269	NA
Transportation	153, 421		142, 978	NA
Maintenance equipment	86, 463		80, 146	NA
Maintenance way	59, 895		54, 736	NA
Subtotal	335, 969		315, 156	306, 553
Equipment rents	44, 446		39, 327	41, 166
Corporation adjustment (Cr.)	6, 000		6, 000	4, 991
Total Oper. Depts	374, 415	356, 116	348, 483	342, 728
Executive offices	904		856	839
Treasury and investment	1, 068		1, 068	1, 321
Accounting, budget, taxes	4, 703		4, 703	5, 447
Management planning	152		152	85
Public relations	977		977	618
Research	351		351	326
Services	294		294	243
Traffic	5, 057		5, 057	6, 141
Legal	1, 663		1, 663	1, 986
System development	6, 042		6, 042	6, 066
Labor relations	905		905	955
Secretary	299		299	374
Ind. dev. and real estate	832		832	876
Material and purchasing	3, 027		3, 027	3, 629
Total system offices	26, 274		26, 226	28, 906
Total operation and system offices	400, 689		374, 709	371, 634
Taxes	8, 408	6, 408	8, 353	7, 934
Total expenses	409, 097		383, 062	379, 568
Income (loss) from operations	(16, 722)		19, 688	6, 409
Other expenses	15, 366		11, 873	7, 413
Net income (loss)	(32, 088)		7, 815	(1, 004)
New Haven operations	(1, 542)			(4, 950)
Capitalized maintenance	8, 561			
Gain on property sales	4, 162		5, 280	7, 675
Subsidiaries:				
D.T. & I	909		909	779
I.H.B. R.R	(182)		(497)	255
P.R.S.L	(1, 127)		(1, 127)	(1, 179)
P. & L.E. R.R	2, 384		2, 462	2, 425
Other operating R.R	(128)		(296)	115
Lessor railroads	2, 810		2, 823	2, 673
Equipment lease Companies	674		674	654
Truck Co	2, 362		2, 374	2, 234
Pennsylvania Co	8, 960		9, 037	9, 285
Arvida	786		786	643
Buckeye	2, 242	2, 500	2, 242	3, 160
Great South West	282	524	463	1, 744
Macco	4, 000	6, 000	4, 000	4, 265
Others	1, 856		(333)	412
Adj. and elim	(13, 258)		(11, 568)	(10, 515)
Total subsidiaries	12, 570		11, 949	16, 950

Footnote at end of table, p. 737.

SECOND QUARTER 1969—RAILROAD EXCLUDING PROPERTY SALES AND NEW HAVEN—Continued

[Dollars in thousands]—Continued

	2d quarter 1969 forecast, May 5, 1969	Goal	2d quarter 1969 budget	2d quarter 1968 [1]
Quarter earnings:				
Parent	($23,765)	$6,909	$9,505	($3,537)
Subsidiaries	15,428	17,928	15,539	22,208
Total	(8,337)	24,837	25,044	18,671
Other transactions:				
Bonds				
N. & W. stock				
Dallas Park (gross proceeds)		14,000		

[1] Restated to exclude New York Central Transport Co.

Supplement "A"

PENN CENTRAL CO.—EXPENSES, TOTAL OPERATING DEPARTMENT, 2d QUARTER 1969

[In Thousands]

	May 5, 1969 Forecast	Budget	April 29, 1969 forecast	Variance from, April 29, 1969 Budget	Forecast
Operations—System	$41,954	$40,505	$42,187	($1,449)	$233
Heavy maintenance shops	16,114	13,848	16,226	(2,266)	112
Eastern region	47,973	46,461	48,133	(1,512)	160
Central region	50,417	46,156	50,815	(4,261)	398
Western region	23,521	21,997	23,803	(1,524)	282
New York region	33,334	32,647	32,894	(687)	(440)
Northeastern region	30,286	26,740	30,418	(3,546)	132
Lake region	24,958	23,729	25,440	(1,229)	482
Northern region	19,671	18,181	19,857	(1,490)	186
Southern region	46,866	44,236	47,583	(2,630)	717
Georgia & Eastern Railway	875	767	874	(108)	(1)
Equipment rents	44,446	39,327	43,886	(5,119)	(560)
Corporate adjustments (CR)	6,000	6,000	6,000	0	0
Total operations	374,415	348,594	376,116	(25,821)	1,701
Administration	15,301	16,026	15,724	725	423
Stations	20,889	21,269	21,172	380	283
Transportation:					
Freight operations	106,941	97,400	107,400	(9,541)	459
Passenger operations	15,420	14,965	15,455	(455)	35
Block stations	4,802	4,832	4,774	30	(28)
All other	26,258	25,782	26,744	(476)	486
Total transportation	153,421	142,979	154,373	(10,442)	952
Maintenance of Equipment:					
Car shops	24,889	23,505	24,710	(1,384)	(179)
Enginehouses	18,857	17,447	18,659	(1,410)	(198)
Heavy Maintenance shops	16,114	13,848	16,226	(2,266)	112
All other	26,603	25,346	26,713	(1,257)	110
Total Maintenance of equipment	86,463	80,146	86,308	(6,317)	(155)
Maintenance of works:					
Track	29,961	23,849	30,318	(6,112)	357
Communications and Signals	7,330	7,362	7,324	32	(6)
Structures	5,586	5,645	5,613	59	27
All other	17,018	17,991	17,398	973	380
Total, maintenance of works	59,395	54,847	60,653	(5,048)	758
Equipment rentals	44,446	39,327	43,886	(5,119)	(560)
Corporate adjustments (CR)	6,000	6,000	6,000	0	0
Total, operations	374,415	348,594	376,116	(25,821)	1,701

(#) denotes unfavorable.

Exhibit 77

BOARD MEMORANDUM—WEDNESDAY, JUNE 25, 1969

Proposed Third Quarter Dividend

Last year our Third Quarter dividend action was taken at the June meeting, following the pattern set on the former Pennsylvania Railroad because of the practice of cancelling stated meetings during July and August. Later in the meeting we will consider the schedule to be followed this summer but, whether or not we meet during those months, I understand

that the Exchange rules would require us to make a public announcement if we postpone consideration of the dividend at this time.

As we discussed at the meeting of the Executive and Finance Committees on June 13, preliminary estimates for the Third Quarter of 1969 are about the same as last year when we earned $15.2 million on a consolidated basis.[1] Since then the steel industry has announced that steel orders at midwestern and Eastern mills have broken a 2-month seasonal downturn and officials are now predicting that the third quarter could reach the 23 million ton record level set in 1965. This compares with only 20.8 million tons in the third quarter of last year. Heavy steel activity produces a beneficial effect on other commodities, such as coal and ore.

On the other hand, the coal miners' holiday period, which usually spans part of June and July, will fall entirely in the Third Quarter of this year, inventories of motor vehicles in dealers' hands is rather high, indicating a prolonged changeover period beginning in July, and there is no end in sight to the Canadian ore strike. In short, the general economy continues to show strength, but there are indications that the high cost of money and anti-inflationary measures are having a depressing effect. We are not unaware of the possibility that some of these forces could combine to reduce July and August business below the projected levels and are now making preparations to store locomotives, furlough non-protected employees, and take other economy measures at the first sign of an adverse revenue impact.

Despite these unsettled conditions, the Finance Committee, after consideration of all the factors, recommends the payment of the regular quarterly dividend of 60 cents per share, payable on September 12, 1969, to stockholders of record on August 11.

Will someone make a motion approving that recommendation?

All in favor, please say "aye", opposed say "no". So ordered.

Second quarter 1969

We are still two weeks from the close of the second quarter and some of the factors mentioned in connection with the dividend are affecting current results. However, we are now estimating consolidated net income to be approximately $25 million, or $1.03 per share.[1a] This represents an improvement of $1.4 million, or 5.8% over earnings of $23.6 million in the second quarter of last year.[2]

This is also a substantial improvement over our showing in the first quarter with earnings of only $4.6 million compared with $13.4 million, or a drop of 65.6% from the year before. For the first half consolidated earnings will be $29.6 million, which is 20% below the $37 million earned in the first half of 1968. As indicated by our discussion at the Executive and Finance Committees meeting, we have very good prospects of equalling the $90 million consolidated net income produced in the earlier year.

As far as the second quarter results for the Railroad (i.e., Parent Company) is concerned, we are now forecasting a $5.5 million loss, as compared with a net of $2 million in the second quarter of last year. This is about $5 million below the results we were anticipating only 2 weeks ago. This is the result of: (1) Coal revenues for the month of June being about $1.4 million below earlier estimates because of the John L. Lewis memorial holiday and sporadic wildcat walkouts resulting from internal union politics;

[1] All 1968 earnings data in the text exclude the New Haven, which reported a $6.4 million loss in Third Quarter of last year.

Last year's results included $11.7 million Washington Terminal dividend, but this is expected to be matched in the Third Quarter of 1969 by a $12 million profit in the Rancho California transaction.

[1a] Earnings (thousands):

	1969	1968	Variance	Percent
1st quarter (actual):				
Parent	($12, 764)	$1, 026	($13, 790)	
Other	17, 365	12, 362	5, 003	40. 5
Consolicated	4, 601	13, 388	(8, 787)	(65. 6)
2d quarter (estimate):				
Parent	[a] (5, 500)	2, 065	(7, 565)	
Other	[a] 30, 500	21, 556	8, 944	41. 5
Consolidated	[a] 25, 000	23, 621	1, 379	5. 8
6 months:				
Parent	(18, 264)	3, 091	(21, 355)	
Other	47, 865	33, 918	13, 947	41. 1
Consolidated	29, 601	37, 009	(7, 408)	20. 0

[a] The forecast for the second quarter contemplates a $8,600,000 improvement from the mid-June forecast (in line with the goals assigned at the June 23 budget meeting) and a $11,000,000 special dividend from the subsidiaries to parent company.

[2] The 1968 figure does not reflect a $4.9 million loss reported by the New Haven in the second quarter of last year.

(2) The Canadian strike on the Great Lakes, which will cost us about $200,000 in June; and (3) Work stoppage in General Motors plants, which produced an abnormally low motor vehicle output 15.4 percent below 1968, resulting in revenue losses of about $1 million earlier this month. The balance of the decline (nearly $4 million) was apparently produced by a billing lag and lost production in plants we serve during the long Memorial Day weekend at the end of May.

Although these results are disappointing, they are mainly from developments beyond our control and there is ample evidence that we have overcome our service problems and are rapidly regaining lost traffic. Operating revenues for the second quarter are now expected to be $388.5 million [3] or a gain of $13.9 million (3.7%) over the first quarter and $2.5 million (0.7%) ahead of second quarter last year. Freight revenues show an improvement of $3.4 million over the 1968 (1.0%) and, due to the Metroliner and some minor commuter fare increase, passenger revenues are $2 million or 7.9% ahead of second quarter last year. Unfortunately, these gains were greatly reduced by mail and express losses of $4.7 million or 25.8% under second quarter 1968.

Another indication of service improvement is that our share of Eastern District ton miles increased 0.5%, to 33.9%, which is the equivalent of 235 million net ton miles, or $4.5 million in revenues, based on the current yield of 1.9¢ per ton mile.

Operating Costs.—Operating costs in the second quarter are projected at $400.5 million, which is an $11.6 million increase (or 3%) over first quarter costs of $389 million.[4] Since July of last year wage rates and retirement taxes have gone up 7.6% per employee [5] although, by stringent controls over employment, our total labor costs for the last 6 months of 1969 have risen only 2.3%.[6] Our average employment for the second quarter (months of April, May and June) was 99,732, which is down 4,164 or 4% compared with the same three months of last year. Labor costs, which were $6 million above second quarter of last year, would have been $11 million higher had it not been for this force reduction.

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[3] Operating revenues (thousands):

	1969 2d quarter	Variance from—1969 1st quarter	1969 Percent	1968 2d quarter	1968 Percent
Freight	[a] $328,063	+$11,131	3.5	+$3,408	1.0
Passenger	27,786	+1,571	6.0	+2,040	7.9
Mail	12,836	−954	6.9	−2,307	15.2
Express	679	−381	35.9	−2,396	77.9
All other	19,138	−2,502	15.0	+1,780	10.3
Total	388,502	−13,869	3.7	+2,525	.7

[a] Freight revenues reflect an increase of $5,000,000 over the mid-June forecast, in line with the discussion at budget meeting on June 23.

[4] Operating costs (thousands):

	1969 2d quarter	Variance from—1969 1st quarter	1969 Percent	1968 2d quarter	1968 Percent
System offices	$27,136	+$1,378	5.3	−$1,770	6.1
Operations	[a]320,676	+8,083	2.6	+19,114	6.3
Equipment rents	44,657	+1,542	3.6	+3,491	8.5
Taxes	8,057	+547	7.2	+123	1.6
Total	400,526	+11,550	3.0	+20,958	5.5

[a] $3,600,000 below the mid-June estimates, in line with goal assigned on June 2.

[5] Wage rates increased 3.5 percent on July 1, 1968, and 2 percent on Jan. 1, 1969. Railroad retirement tax rate increased from 8.9 percent to 9.55 percent on Jan. 1, 1969. These taxes also increased by reason of higher taxable wages due to the wa e rate grants.

[6] Employment:

	Employees	Labor costs	Per employee
1st half—1969	98,212	$524,000	$5,335
1st half—1968	103,210	$512,000	$4,960
Variance	−4,998	+$12,000	+$375
Percent	−4.8	+2.3	+7.6
2d quarter—1969	99,732	$264,000	$2,647
2d quarter—1968	103,896	$258,000	$2,483
Variance	−4,164	+$6,000	+$164
Percent	−4.0	+2.3	+6.6

A second round of wage rate increases this year goes into effect on July 1, hiking wages another 3%. This is estimated to cost an additional $13.5 million during the last half based on our present employment level. While we hope to secure selective rate increases amounting to about $10 million on an annual basis, there is no general freight rate increase in immediate prospect and these increased costs can only be offset by even more austere measures in the future.

Another real concern at this time has to do with the recent rise in the prime interest rate to 8½%. Not only has this contributed to the increased cost of borrowing funds, which is already 34% higher this year,[7] but the tight-money situation makes it difficult to finance the capital improvements which are essential for implementing the merger and obtaining operating economies.

Our operating results in the second quarter were again greatly influenced by nonrecurring merger "start-up" costs. Current figures ae not yet available but, based on our experience during the first three months of this year,[8] I estimate that these expenditures amounted to more $125 million, with cumulative savings of about $2 milion, producing an adverse effect of about $5 million in the income account.

PENN CENTRAL CO. (INCLUDING NEW HAVEN) MERGER STARTUP COST AND SAVINGS

1ST QUARTER 1969

	Amounts reflected in—			
	Income	Reserve	Capital	Total
Costs:				
Personnel	$2,887,072	$4,946,000	$261,319	$8,094,391
Properties:				
A. E. Perlman yard			2,062,000	2,062,000
Columbus yard			1,028,660	1,028,660
Stanley yard			640,362	640,362
Big Four yard			948,901	948,901
Seneca yard			532,000	532,000
Rensselaer passenger station			544,000	544,000
Fairlane control siding			282,595	282,595
Karner N.Y. passenger station			306,000	306,000
Sharonville yard			250,915	250,915
Cinci-Columbus signals			217,190	217,190
Other (each under 200,000)		1,126,000	360,910	1,486,910
Total, properties		1,126,000	7,173,533	8,299,533
Service	17,266,000			17,266,000
Total costs	20,153,072	6,072,000	7,434,852	33,659,924
Savings:				
Elim-Consol fixed facilities	6,913,960			6,913,960
Maintenance of equipment	3,023,320			3,023,320
Maintenance of roadway	392,255			392,255
Train operations	2,507,690			2,507,690
Labor not included above	4,554,919			4,554,919
Property taxes, insurance	3,000			3,000
Total savings	17,395,144			17,395,144
Net savings (costs)	(2,757,928)			(16,264,780)
Ratio, costs to savings	1.16:1			1.94:1

[7] Interest on funded debt:

1969 (6 months)	$42,500,000
1968 (6 months)	31,800,000
Variance (increase)	10,700,000
Percent	33.6

[8] Merger "start-up" costs and savings:

	Amounts reflected in—		
	Income	Reserve and capital	Total
1st quarter 1969:			
Costs and losses	$20,153,072	$13,506,852	$33,659,924
Saving	17,395,144		17,395,144
Net savings (costs)	(2,757,928)		(16,264,780)
Ratio costs to savings	1.16:1		1.94:1
Feb. 1, 1968 to Mar. 31, 1969:			
Costs and losses	$95,009,165	$82,376,246	$191,385,411
Savings	39,887,496		39,887,496
Net savings (costs)	(55,121,669)		(151,497,915)
Ratio costs to savings	2.38:1		4.80:1

[a] Including advances of $14,000,000 to New Haven in 1968, applied to purchase price.

The most significant factor in producing net income on a consolidated basis in the second quarter was the gain realized by Great Southwest in the sale of Six Flags over Texas, the Dallas Amusement Park, in a transaction similar to the sale of the Atlanta Park last year. This deal—which is to produce a net gain of about $25 million—will be explained in detail by Dave Bevan.

Macco and Great Southwest are also up about $1.8 million in ordinary income, but Buckeye is about $600 thousand below Second Quarter last year.

Aside from this, the undistributed earnings of the subsidiaries, especially Manor Real Estate and the leased lines, are about $5.4 million below second quarter last year. This is primarily due to a drop in real estate sales—the direct result of the high interest situation (see table below).

SIGNIFICANT ITEMS, 2ND QUARTER

	1969	1968	Increase (+) or decrease (−)
Subsidiaries—Undistributed earnings	$16,359	$21,556	−$5,197
Sale or properties:			
Lessor railroads (various)			1,489
Manor Real Estate (sale in 1968 to Republic Steel)			2,205
Strick profits (sale of company in 1968)			−492
Other operating railroads			−526
Indianapolis Union			−256
Federal income tax credit 1968:			
Monongahela railway			−179
Waynesburg Southern startup costs			−435
Buckeye pipeline			−658
Federal income tax credit, 1968			−476
Other taxes increased			−166
Total			−642
			−5,370
Dallas Park			+25,000
			+19,630

Grand Central Terminal—Tower Building.—The New York City Administration continues to oppose our Grand Central Terminal Tower project with the result that the Landmark Commission has again raised technical objections to our plans. While the architect has prepared new plans, we are weighing the advantages of a course of action urged by the City in keeping with its legal position.

New York feels that we cannot be denied the right to proceed unless we are offered equivalent rights elsewhere. Accordingly, it is suggested that if we will drop our plans we will be permitted to transfer our Grand Central rights to other parcels of property. Our Real Estate people have made some preliminary calculations based on a transfer of the air rights to the 466 Lexington Avenue site and the Biltmore or Roosevelt Hotel sites, and it appears possible that such a plan could net us anywhere from $700,000 to $2.0 million more than the Grand Central Tower plan. However, a number of changes will be required in the applicable law and there is some doubt that the City will be able to accomplish them.

We will, of course, make careful studies of all of the alternatives before making any decision which would forfeit our Grand Central rights.

Service.—There has been a decided improvement in the overall service performance during the last two months. Shippers who were routing against Penn Central during 1968 and early in 1969, are returning their long-haul traffic to us and continue to write us concerning the significant measure of our recovery. As of June 10, the improvements in our service had resulted in gains of lost traffic totaling about $9 million on an annual basis.

Our shipper contract program is still being actively progressed. The Task Force consisting of sales and operating personnel has made 80 calls with system representation and 611 calls with regional, divisional and district representation. You wil recall that the purpose of this group is to identify the service problems of the shipper and initiate appropriate corrective measures.

In order to be prepared for the traffic peaks anticipated in October, we have initiated a locomotive acquisition program which will make available 150 2,000-horse power units before the end of October. By June 17, eleven of those units had been shipped to us.

Inclusion to Date.—The terms of the program for the purchase and lease of the West End commutation service have been agreed upon in principle with New York (MTA) and Connecticut (CTA). Now that legislative authorization enabling CTA to consummate the transaction has been obtained, implementation of the program awaits only the restructuring of passenger fares in the West End area. Our objective is an effective date prior to September 1.

In the interim period, studies concerning the type of new equipment to be purchased, modernization of power between Grand Central Terminal and Woodlawn, and the location of a new shop facility supporting the Hudson, Harlem and New Haven commutation services will be progressed.

You probably noted in the press that on June 9, a 3-hour, 39-minute run was instituted for the Turboservice between Boston and New York. This cuts 16 minutes from the previous running time and has been determined to be the optimum schedule under present track conditions. A program to advertise the new schedule is being progressed with funds authorized by the Department of Transportation.

We have informed the Secretary of Transportation that no further reductions in TurboTrain running time can be made without substantial programs of track upgrading and grade crossing elimination and that funding of such programs must be the responsibility of the Federal government.

As I have indicated in the past, it is imperative that we continue to receive the state subsidies and tax relief which the New Haven received. Contracts in support of our long-haul passenger services have now been signed with Connecticut and Rhode Island assuring aid from the two states in the amount of $1,335,000 during 1969. While a legislative controversy has temporarily blocked authorization of the aid promised by Massachusetts, it is hoped that a special bill being readied for early submission will remedy this situation.

Negotiations have begun with both Connecticut and Rhode Island on permanent support programs.

The Legislatures of Connecticut and Massachusetts made no changes in the basic tax relief programs this year. However, the relief is contingent upon Penn Central meeting set standards of passenger service and upon the West End program. In Rhode Island, a compromise was reached in the closing moments of the Legislature which continues the important principle of railroad tax relief with full exemption from the gross earnings tax and a 25% exemption on property taxes.

PASSENGER—LOSSES AND METROLINER

Losses.—We are continuing our efforts to reduce our passenger service losses which in the first quarter were $26 million as compared with $28.8 million for last year. As of June 13, our passenger train service withdrawal program included proceedings involving 12 trains which, if discontinued, would reduce our passenger train mileage by 1,634,725 miles and would effect savings of approximately $3,990,291.

It is anticipated that the studies now being progressed relating to our overall passenger service restructuring program will be completed in August. You will recall that our preliminary studies indicate that discontinuance of all long-haul service west of Harrisburg and Buffalo would eliminate 8.8 million train miles annually, producing net savings of $21 million a year. This does not include the Boston-Washington corridor or the Empire Service in New York State—both of which are being reviewed for potential savings.

Metroliner Operations.—Our experience with the Metroliner operation continues to be quite favorable. For the period January 16 through June 15, we had a total of 208,377 passengers and a seat mile utilization factor of 76.7 percent. The estimated revenue was $2.3 million. Our on-time performance for the period was 88.3 percent.

Long Island Divisions Case.—The petition of the Long Island Rail Road for an investigation of its divisions of joint rates has been denied by the Interstate Commerce Commission. This remits the Long Island to the filing of a complaint if it desires to pursue this matter. The procedural difference between an investigation by the Commission and a complaint case is rather slight when the investigation results from a petition filed by one who seeks affirmative relief and thus has the burden of proof.

Status of Holding Company Proposal Before the ICC.—The State of New Jersey and the New Jersey Board of Public Utility Commissioners filed a petition for leave to intervene in our holding company proceeding for the purpose of determining what effect it might have on transportation within New Jersey. There are no other intervenors.

If the State of New Jersey can be persuaded to withdraw promptly, the matter can be expeditiously processed to a decision; and if Division 3 is willing to approve the application, a decision in June is possible.

Ohio Full Crew Case—The Supreme Court of Ohio which, on April 16, 1969, dismissed the railroads' appeal of a lower court decision upholding the constitutionality of the full crew law of that state, has now denied the railroads' motion for rehearing. Remedies for overturning the state law in the Ohio courts have now been exhausted; and it is the consensus of the railroad Legal Committee that it would be useless to attempt certiorari to the Supreme Court of the United States, which earlier this year refused to hear an appeal of the New York full crew case, and which on two occasions reversed decisions in Arkansas cases favorable to the railroads. Furthermore, no new issue under the Federal Constitution is involved in the Ohio case.

New York Public Utility Commission Investigation of Penn Central Service.—On June 5, 1969, the New York Public Service Commission ordered the Penn Central to make immediate arrangements for the acquisition of at least eighty new multiple unit passenger cars for the replacement within two years of specified existing MU cars and certain heavyweight cars presently used in the electrified territory.

The order also directed Penn Central to replace twenty-four existing P&T locomotives used in suburban service with more modern power units within the next two years.

It further directed Penn Central to increase its program for track surfacing in suburban territory from its present program of 69 miles per year to 100 miles for the next two years.

The order also directed the continuation of certain programs of track work, the maintenance of right of way so as to provide adequate and safe operation, and the installation of public address systems at suburban stations within the next two years.

The proceeding in which the order was made began in the Summer of 1968 and was

related to tax relief under which Penn Central realized annual tax savings of from $14 to $17 million.

General Attorney Smith, in New York, states that the order contains two "substantially objectionable conditions". The first of these is the requirement to increase track surfacing to 100 miles per year in the suburban territory. According to the Chief Engineer, the addition of new equipment will afford the capacity to meet this requirement.

Mr. Smith also states that he has been advised that twenty-four P&T class engines will in fact be replaced this year with more modern power units.

With respect to the acquisition of eighty new multiple unit cars, there is some question as to whether adequate notice was given that this subject would be considered in this phase of the investigation and there is some question as to the evidentiary basis for such an order.

Mr. Smith has expressed the opinion that the New York Public Service Commission is endeavoring by this order to force the Metropolitan Transportation Authority to acquire equipment and lease it to the railroads engaged in communter service.

A petition for rehearing and reconsideration will be filed with the New York Commission to protect our right of appeal.

Exhibit 78

[Interstate Commerce Commission, Docket No. 35291 Verified Statement 4, Exhibit DD7]

PENN CENTRAL—COMPUTATION OF INTEREST COST RELATIVE TO MONEY BORROWED TO REPLACE MONEY EXPENDED THROUGH DIVIDEND PAYMENTS, JAN. 1, 1963, THROUGH JUNE 30, 1970

	Dividends paid	Cumulative value	Interest rate	Year	Interes cos
1963	$10,026,872	$10,026,872	4.63	1964	$464,244
1964	28,974,596	39,001,468	4.67	1965	1,821,369
1965	45,386,910	84,388,378	5.71	1966	4,818,576
1966	53,646,666	138,035,044	6.25	1967	8,627,190
1967	55,051,906	193,086,950	7.76	1968	14,983,551
1968	55,400,358	248,487,308	9.0	1969	22,363,857
1969	43,396,217	291,883,525	10.0	1970	14,594,176
Total	291,883,525				67,672,963

Penn Central Transportation Company—Summary of cash impact from diversification

	(In millions)
Cash expended by transportation group:	
Stock purchases	$157
Dividends paid downstream	19
Loans and advances	33
Total cash expended	$209
Cash received by transportation group:	
Dividends	41
Proceeds received from sale of assets	15
Total cash received	56
Net cash expenditures from the transportation group	$153
Estimated interests costs	56
Total cash expended from diversification	209

PENN CENTRAL TRANSPORTATION CO.—ANALYSIS OF CASH IMPACT BY COMPANIES FROM DIVERSIFICATION

[In millions]

Companies	Cash from transportation group	Cash to transportation group	Net cash from transportation group
Buckeye	$50	$37	$13
Arvida	22		22
Great Southwest	26	4	22
Macco	61		61
Madison Square Garden	5		5
Executive Jet	21		21
Strick	24	15	9
Total	409	56	153

PENN CENTRAL TRANSPORTATION CO.—Continued

COMPUTATION OF CASH IMPACT TO TRANSPORTATION COMPANIES RESULTING FROM DIVERSIFICATION IN NONRAILROAD ACTIVITIES, JAN. 1, 1963, THROUGH JUNE 30, 1970

[In thousands]

	Buckeye	Arvida	Great Southwest	Macco	Madison Suqare Garden	Executive Jet	Strick	Total
CASH PASSEO DOWNSTREAM TO SUBSIOIARY COMPANIES								
Acquisition of stock:								
1963	$28,170							$28,170
1964	2,197		$14,834			$20		17,050
1965	14	18,335	6,111	$39,315		253		64,028
1966		3,712	4,712	136		72	$15,000	23,633
1967			[1] 3,000	(6,000)				9,000
1968			357	[1] (7,400)				7,757
1969				(5,500)	2,000			7,500
Total	30,381	22,047	29,014	58,351	2,000	345	15,000	157,138
Oividends paid downstream in connection with acquisition of stock:								
1964	1,530							1,530
1965	3,268							3,268
1966	3,265							3,265
1967	3,265							3,265
1968	3,264							3,264
1969	3,264							3,264
1970	1,632							1,632
Total	[2] 19,488							19,488
Loans and advances:								
1963								
1964						575		575
1965						7,588		7,588
1966						5,425	2,997	8,422
1967					244	2,441	6,440	9,225
1968					[3] 2,458	390		2,848
1969						1,324		2,324
1970						2,000		2,000
Total					2,802	20,743	9,437	32,982
Total downstream cash	49,869	22,047	29,041	58,351	4,802	21,088	24,437	209,608
Oividends:								
1963	128							128
1964	3,438							3,438
1965	5,965							5,965
1966	5,800							5,800
1967	6,300		210					6,510
1968	6,300		630					6,930
1969	6,300		3,416					9,716
1970	3,100							3,100
Total	37,331		4,256					41,587
Sale of assets							15,000	15,000
Total, cash returned	37,331		4,256				15,000	56,587
Net cash from transportation group	12,538	22,047	24,758	58,351	4,802	21,088	9,437	153,021

[1] Originally advanced as cash in 1967, 1968, and 1969. Converted to capital stock in December 1969.
[2] Dividend payments on Pennsylvania Co. preferred stock issued in connection with acquisition of Buckeye Pipeline Co.
[3] Advances made to predecessor company—Pennsylvania Terminal Real Estate Co.

PENN CENTRAL TRANSPORTATION CO.—COMPUTATION OF INTEREST COST RELATIVE TO MONEY BORROWED TO REPLACE MONEY EXPENDED IN CONNECTION WITH DIVERSIFICATION PROGRAM, JAN. 1, 1963 THROUGH JUNE 30, 1970

[In thousands]

Year (1)	Cash paid out (2)	Cash received (3)	Net cash outlay by year (4)	Total cash outlay (5)	Interest rate (6)	Interest [1] (7)
1963	$28,169	$129	$28,040	$28,040	4.52	$634
1964	19,155	3,438	15,717	43,757	4.63	1,662
1965	74,884	5,965	68,919	112,676	4.67	3,653
1966	35,319	5,800	29,519	142,195	5.71	7,277
1967	21,490	6,510	14,980	157,175	6.25	9,355
1968	13,870	6,931	6,939	164,114	7.76	12,466
1969	13,088	[2] 24,716	(11,627)	152,487	8.66	13,709
1970 (6 months)	3,632	3,100	532	153,019	10.00	7,638
Total	209,607	56,589	153,019			56,394

[1] Interest computed by average balance outstanding for year.
[2] Includes $15,000,000 received for sale of Strick Holding Co., 1968.

Penn Central Transportation Company equipment financing—Interest rates [1]

	Percent		Percent
1960	5.22	1966	5.71
1961	5.04	1967	6.25
1962	4.91	1968	7.76
1963	4.52	1969	8.66
1964	4.63	Last quarter of 1969	10.00
1965	4.67		

[1] Source of interest rates from sheet 1. The above affective interest rates were presented to the Commission by Mr. Jervis Langdon on behalf of Penn Central Transportation Company in his verified statement in support of freight rate increases in Docket 267.

Exhibit 79

SEPTA.—Charlie Ingersoll thinks that the proposal to reform the SEPTA Board that Mr. Bertrand called you about is both beneficial and politically feasible. He and Dick Tomlinson are putting together what they describe as a "position paper" on the center city connection and other items to be negotiated with SEPTA. They are also working on a letter for you and Mr. Bertrand, setting forth suggested ground rules and procedural guidelines to govern future relations between SEPTA and the two railroads.

P&LE merger.—No plan for including the P&LE in the Penn Central has been formulated. At one time there was talk of obtaining appropriate approvals at the meeting of the P&LE Board on December 11, but this schedule was abandoned when it was realized that (1) merger into Penndel (which was the original proposal) would carry with it several disadvantageous legal consequences; (2) that no study to determine whether physical consolidation is operationally or economically feasible had ever been conducted; and (3) that the cost of protecting P&LE employes whether or not there was physical inclusion would undoubtedly outweigh any advantage from squeezing out minority shareholders.

Consideration is now being given to what Ted Warner calls a "reverse" merger, which would involve creating a new Delaware corporation and merging it *into* P&LE. He says that this has the same effect in eliminating minority interests as the standard merger but would not have the same adverse labor consequences, despite any conditions that might be prescribed by the I.C.C., since there would be no effect on employes arising out of this transaction. Whether or not to thereafter consolidate P&LE operations and properties could be determined on the basis of a study concerning the economic advantages and disadvantages of taking this next step.

Consultants.—Attached is a list of the firms and individuals who received payment as consultants during the month of October. I am obtaining an explanation for those we do not already know about. With reference to Joe Borkin, you will be interested to know that he is being paid $2,750 per month on a regular basis. Last year he received a total of $56,075 from the Central! In view of your instruction to discontinue the use of consultants wherever possible, I have arranged for a continuing check and report on payments being made in this account.

Cash situation.—Our cash balance is down to $28.7 million, due mainly to a $42 million bond issue that matured earlier this week. The program to generate cash seems to be going well, although it is impossible to put a dollar value on the results to date:

Capital Expenditures.—The M–W people assure me that deferred road improvements add to $23 million, and probably more, but I have been unable to get a fix on the exact amount because the man with the figures (Pete Piper) is out on the road. I will keep after him.

Inventory.—Mal Richards' dispute with the accountants has been resolved in his favor, but the projected year-end balance is still $85 million. It would be lower except for the deferred construction. What is more significant, current cash outlay has been cut to the bone, primarily by deferred fuel and tie purchases, with a favorable effect on cash outlay from $3 to $4 million. For the year to date, total purchases are running $5 to $6 million below last year.

Scrap Sales.—Bids are due on Monday on offers to sell in place scrap in the New York Harbor area and Sunnyside Yard. It is difficult to estimate the cash effect because the buyers' cost in removing the structures is an offsetting element. These are extraordinary transactions in excess of the normal scrap sales of approximately $2 million per month.

Real Estate Sales.—While I do not have a figure as to the cash expected from real estate sales this quarter, my guess is that the amount actually generated will be substantially greater because the forecast of closings this quarter is now $7.9 million, which is more than double the initial estimate. In addition, about a half-million dollars cash will be received in connection with the coal lands sale.

Accounts Receivable.—A special study to identify the most fruitful areas for concentrating the effort to collect outstanding bills has produced the following information about delinquent (over 10 days) accounts:

Number of firms whose delinquent accounts total

$2 million	2	$7 million	35
$3 million	5	$8 million	50
$4 million	8	$9 million	88
$5 million	15	$10 million	161
$6 million	23		

Some of the large offenders are holding back as an offset against unpaid freight claims. When these firms are all identified, various officers in the organization will be requested to contact them specially.

The Accounts Receivable balance is now $75 million, which is $15 million higher than it was assumed to be in October. This does not represent a loss of position as much as it does identifying more accurately the scope of the problem. This effort to collect outstanding bills will have a continuing beneficial effect in improving the policing of the account to keep shippers on a more current basis.

1969 income projection.—As anticipated, the revenue and expense figures reported yesterday did not conform to the standards prescribed and are now in the process of revision. The Staff Meeting originally set for December 9 has been postponed until Friday, December 13, but we expect to have sufficient detail by Monday afternoon for the Budget group to consider preliminarily the 1969 income projection. I am preparing an analysis of the figures for your use.

Basil Cole.

Exhibit 80

Peat, Marwick, Mitchell & Co.,
Certified Public Accountant,
Philadelphia, Pa., June 3, 1969.

Mr. Stuart T. Saunders,
Chairman of the Board, Penn Central Co.,
Philadelphia, Pa.,

Dear Mr. Saunders: Our examination of the financial statements of Penn Central Company and subsidiaries for the year ended December 31, 1968 was completed on March 7, 1969. As is our customary practice following an examination, we now present for your consideration comments and recommendations with respect to internal controls and accounting procedures.

The comments contained herein represent a summary of the more important matters which came to our attention during the course of our regular examination and are not the result of a special study of the accounting system. Separate letters with specific comments on individual accounting matters related to their respective functions have been addressed to Mr. Hill, Comptroller, Mr. Shaffer, Treasurer, and Mr. McTernan, Assistant Vice Presi-

dent-Budgets and Controls. In addition, Mr. Hill has received a complete copy of all of our comments and recommendations.

System (corporate) accounting

It is our opinion that significant time savings and improved reporting would result from mechanization of presently hand-posted ledgers and implementation of standard forms for recording recurring journal entries, reporting of operating results by subsidiary companies and preparation of bank reconciliations.

A considerable time-lag occurs in the closing of balance-sheet accounts at the end of each calendar month. For example, accounts for the month of September 1968 were not closed until late in November. The principal causes of this time-lag appear to be delays in the receipt of information from the Treasurer's Office and Systems Development (Data Processing) Department. Also, as 1968 was the first year of merged operations, this contributed to some extent to the delays experienced. Balance-sheet data is only effective as an operating tool if received on a timely basis. Considering the computer capacity available and the opportunities for the use of increased mechanization, it should be possible to substantially reduce the current time-lag in monthly reporting.

Presently, reconciliations of account details to the general ledger are not consistently made at the end of each month. Monthly reconciliations of supporting ledgers with the general ledger are essential in the operations of an efficient accounting system.

Bank account reconciliations are not prepared promptly by the Treasurer's Office at the close of an accounting month. Delays of as long as three to five months occurred in the preparation of such reconciliations. This is also true with respect to the reconciliation of the detail of "estimated checks and drafts outstanding" to the general ledger, a reconciliation of which, in fact, has not been made since 1965 for certain portions of the account. Obviously, failure to reconcile promptly bank accounts and outstanding checks and drafts causes a serious breakdown in the maintenance of an effective system of internal control. In addition, the present bank reconciliations are prepared on typed sheets, the form of which varies from month to month and does not lend itself to quick and intelligent review. We recommend that the procedures followed with respect to reconciliation of bank accounts and outstanding drafts be carefully reviewed. We understand that such a review has been initiated recently.

There is no detailed listing of "audited bills payable" to support the balance carried in the general ledger. We recommend that a listing be prepared and balanced with the general ledger at least on a quarterly basis.

Physical inventories are taken annually over a period of months beginning in April and extending through August. The compilation of the physical inventories was not completed until late in December. Every attempt should be made to reduce this time-lag.

There was a serious reversal in the timeliness of accounts receivable collections during the year. Admittedly, this was caused, in part, by the conversion to a uniform accounts receivable system for the merged roads. Replies received to our requests for confirmation of account balances often included copies of letters written by patrons requesting that old and disputed items be clarified to permit payment of account balances. The patrons indicated that they had not received responses to these letters from company personnel. Prompt follow-up of such inquiries would not only improve control over accounts receivable records but would also result in an improved cash flow.

Considerable difficulty was experienced in verifying charges to the "merger reserve" account for non-productive employees. Clarification of the definition of a non-productive employee, properly disseminated to regional operating personnel, should eliminate this problem.

The effectiveness of the Internal Audit Department would be enhanced, if it were to make greater use of computer processing and operational or procedural auditing techniques.

Regional accounting

Amounts included in "Auditer Items Awaiting Billing" should be relieved from the account on a timely basis so as to reduce costly analysis to determine the composition of the account balance.

Documentation of charges against the merger reserve, including information as to the reason for such charges, should be improved.

We noted numerous instances where authorizations for the purchase or construction of capital items were exceeded without additional approval. We also noted instances where authorizations for capital projects were used for purposes other than those stipulated in the original authorization. A procedure should be instituted to ensure that situations of this nature are not allowed to recur.

Subsidiary records are not balanced on a regular basis to the controlling accounts in the region general ledgers. Regular reconciliation procedures of this nature are essential to good internal control and would facilitate preparation of financial statements by the regions.

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Should you have any questions concerning these matters, we would be pleased to discuss them with you at your convenience.

We would like to express our appreciation to the officers and employees of the company for the cooperation received during the course of our examination.

Very truly yours,

HENRY A. QUINN, *Partner.*

PENN CENTRAL TRANSPORTATION CO. (COMPANY ONLY)

STATEMENT OF SOURCES AND APPLICATIONS OF FUNDS, FOR PERIODS ENDED DEC. 31, 1960 TO DEC. 31, 1969

[In thousands of dollars]

	1960–69 totals	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
Sources:											
Net income (loss)	149, 900	(6, 800)	(9, 000)	(7, 000)	16, 200	56, 200	75, 400	95, 200	15, 300	(2, 800)	(82, 800)
Plus depreciation	951, 700	98, 500	95, 900	94, 600	93, 600	90, 800	93, 800	96, 500	94, 900	96, 200	96, 900
Less identified noncash transactions	(132, 000)									(74, 400)	(57, 600)
Total	969, 600	91, 700	86, 900	97, 600	109, 800	147, 000	169, 200	191, 700	110, 200	19, 000	(43, 500)
Increase in capital stock (principally options)	8, 600			4, 300		2, 100	2, 200				
Sale of capital assets	343, 300	24, 200	36, 500	34, 500	11, 700	64, 600	20, 600	13, 900	23, 000	59, 700	54, 600
Sale of investments and miscellaneous properties	322, 800	33, 600		28, 600	36, 400	16, 500	47, 900	75, 800			84, 000
Sale of investments to Pennsylvania Co	29, 500				6, 000	4, 600	18, 300	600			
Equipment financing:											
CSA	670, 900	22, 100	45, 400	54, 000	26, 800	103, 800	119, 600	93, 400	55, 000	76, 000	74, 800
ETC	117, 100	4, 600	8, 000	0	7, 900	15, 700	25, 600	33, 600	21, 700		
Leasing	546, 900	107, 200	12, 600	18, 000	36, 300	12, 500	69, 800	27, 000	72, 600	104, 000	86, 900
Total equipment financing	1, 334, 900	133, 900	66, 000	72, 000	71, 000	132, 000	215, 000	154, 000	149, 300	169, 400	171, 700
Other borrowings and advances	799, 100	18, 900		1, 100	20, 400		103, 400	47, 300	77, 900	252, 400	277, 700
Total sources	3, 807, 800	302, 300	189, 400	228, 100	255, 300	366, 800	576, 600	483, 300	360, 400	429, 100	534, 500
Applications of funds:											
Dividends	307, 100	6, 600	3, 300	5, 400	10, 000	29, 000	45, 400	53, 600	55, 000	55, 400	43, 400
Capital expenditures:											
Road	571, 900	28, 500	25, 500	28, 500	27, 800	45, 400	68, 500	76, 900	83, 400	89, 800	97, 600
Equipment	1, 056, 500	59, 700	57, 200	56, 600	74, 200	122, 200	214, 300	184, 300	100, 400	104, 200	83, 400
Leasing	546, 900	107, 200	12, 600	18, 000	36, 300	12, 500	69, 800	27, 000	72, 600	104, 000	86, 900
Total	2, 715, 300	195, 400	95, 300	103, 100	138, 300	180, 100	352, 600	288, 200	256, 400	298, 000	267, 900
Other capital expenditures	36, 000					36, 000					
Debt reduction	1, 141, 400	120, 500	76, 000	111, 800	120, 500	108, 000	148, 000	136, 000	81, 900	159, 400	79, 300
Investments and advances	5, 800		2, 300		3, 500						
Increase in special funds, expenditures charged to merger reserve	36, 300									20, 500	15, 800
Miscellaneous	31, 400		18, 500	12, 900							
Total applications	3, 733, 300	322, 500	195, 400	233, 200	272, 300	353, 100	546, 000	477, 800	393, 300	533, 300	53, 900
Increase (decrease) in net working capital	(81, 700)	(20, 200)	(6, 000)	(5, 100)	(17, 000)	13, 700	30, 600	5, 500	(32, 900)	(104, 200)	53, 900

[1] For more complete table, see Appendix D, Exhibit 81.